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DEFENSE CONTRACTOR EMPLOYEE
OVERSEAS COMPENSATION AND THE
FOREIGN EARNED INCOME ACT OF 1978

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LSSR 10-80

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The objective of this research was to develop a definitive DOD pricing instruction for tax allowance compensation. The instruction applies to service contracts for personnel involved in AF and FMS contracts overseas. The information provided to the individual taxpayer by the IRS was consolidated into a format usable by the AF contract negotiator to set the AF objective for tax allowance. Tax allowance compensation is necessary because of the adverse impact of the Foreign Earned Income Act of 1978 on contract employees going overseas. Basic models were developed to aid the calculation of the tax allowance for a representative contractor employee.

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DEFENSE CONTRACTOR EMPLOYEE OVERSEAS COMPENSATION AND THE FOREIGN EARNED INCOME ACT OF 1978

A Thesis

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of the Air Force Institute of Technology

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In Partial Fulfillment of the Requirements for the

Degree of Master of Science in Logistics Management

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COMMITTEE CHAIRMAN

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CHAPTER I

INTRODUCTION

Overview

The United States is the only industrial trading nation that taxes the worldwide income of its citizens (21:75). The amount of income necessary for an American to live abroad is generally higher than his U.S. income because of the higher cost of living in many foreign countries. Prior to the passage of the Tax Reform Act of 1976, the Air Force (AF) was not asked for compensation by contractors to offset higher personal income taxes on their employees' higher income earned abroad. Before the Tax Reform Act of 1976, employees who earned income abroad were granted a $20,000 or $25,000 exclusion off the top of their income before taxes were computed (9:1). Employees could use the deduction to offset the allowances they were given for higher living costs abroad. Employees in low cost areas overseas whose total compensation was less than the $20,000 or $25,000 exclusion could offset their entire income and pay no U.S. income tax at all.

Also, prior to the passage of the Tax Reform Act of 1976, the AF negotiator did not need a working knowledge of the income tax law. However, the Tax Reform Act of 1976 reduced the exclusion to $15,000 and changed the method of

applying the exclusion in the computation of the tax. This meant a substantial increase in the amount of tax owed by taxpayers working abroad (9:2). Contractor employees, who were enjoying a "windfall" before the passage of the Tax Reform Act of 1976, were now demanding that their employers reimburse them the amount they would have to pay in foreign earned income taxes in excess of their domestic income tax. As the result of pressure from business, Congress delayed the implementation of the Tax Reform Act of 1976 and ordered a study of the impact of the new tax law. In a Report to the Congress (21:V), the Comptroller General of the U.S. found in a survey of 183 U.S. companies employing Americans abroad that:

1. Americans living in the oil-producing countries of the Middle East and Africa will have the largest tax increases, averaging $4,700 per return. Americans working in these countries generally receive a large taxable allowance.
2. In certain extreme cases in extraordinarily high-cost countries, some individuals who receive large cash allowances may have tax liabilities nearly equal to their basic cash salaries [21:V].

The Comptroller General concluded that taxpayers whose employers do not provide additional compensation to cover tax increases will suffer a loss of spendable income (21:58). The Tax Reform Act of 1976, if implemented, would lead to increased program costs as employees under government contracts seek reimbursement for increased taxes. In some instances, requests for compensation had already been planned. In general, agencies had not yet

assessed the budget impact of potential cost increases (21:65).

The report specifically addressed the problems of the Department of Defense (DOD):

> Defense issued guidance in June 1977, that would deny compensation for increased contract costs based directly on employees' tax increases. The guidance would permit compensation increases on current contracts only for performance adjustments. For future contracts, the guidance states that:
> "There is no intent on the part of the DOD to determine as allowable and thereby compensate a U.S. contractor doing business overseas on a DOD contract for increased compensation to employees calculated directly on the basis of each employee's specific increase in U.S. income tax. Nevertheless, the DOD accepts the premise that such contractors must establish both salary and overseas differential compensation sufficient to recruit and retain competent employees to perform a particular contract. In establishing employee compensation including overseas differential, the contractor would properly consider all expense associated with foreign employment, including taxes (other than the amounts of U.S. income tax described above), housing, cost of living adjustments, transportation, bonuses and other related expenses. This compensation may be considered allowable provided it is reasonable and allocable in according with ASPR Section XV" [21:69].

This guidance by DOD was actually issued by the Assistant Secretary of Defense (Installations and Logistics) on 15 February 1977 (1) and was incorporated in DPC #76-9 to the ASPR on 30 August 1977 (18:17). The impact of the guidance will be discussed later in this chapter.

The Comptroller General's report addressed Foreign Military Sales (FMS) only to the extent of competitiveness of suppliers and the reduced availability of qualified personnel for service contracts (21:70). The possibility

that U.S. Allies would request early termination of needed services was not addressed. One of the researchers, as a representative of the 2750th Air Base Wing (ABW) Contracting Division, Contractor Engineering and Technical Services (CETS) Branch, was requested to go to Greece and explain why a CETS contract for one man for one year exceeded the annual salary of the Prime Minister of Greece. The Greek Air Force was informed that one of the reasons was the tax reimbursement the man was receiving.

The researcher was also instructed by the Pacific Air Force (PACAF) to reduce the number of men on its CETS contracts so that PACAF could stay within its budget. Some of the largest tax compensations have gone to CETS persons stationed in Japan.

The AF negotiated CETS contracts in 1976 and 1977 which included compensation for increased employee tax liability. The compensation was based on the estimated additional taxes that contractor's employees would incur due to the Tax Reform Act of 1976. Subsequent to the signing of the contracts, the Congress delayed the implementation of the Act, both in tax years 1976 and 1977. This means that the Air Force paid out dollars to the contractor that will never be paid to the employees. The exact dollar amount may never be known because the Assistant Secretary of Defense (Installation and Logistics) (ASD(I&L)) directed:

> There is no intent on the part of the DOD to determine as allowable . . . compensation to employees calculated directly on the basis of each employee's specific increase in U.S. income tax [1:2].

The AF was allowed, however, to pay the contractor "both salary and overseas differential compensation sufficient to recruit and retain competent employees to perform a particular contract [1:2]." The differential compensation could not be called tax compensation. The Air Force is attempting to obtain voluntary refunds of the tax overpayment (2) but is experiencing difficulty because nowhere in the firm fixed price contracts is the tax compensation called a tax compensation. No U.S. citizen abroad has ever had to file a tax return using only the provisions of the Tax Reform Act of 1976. On 15 October 1978 the 95th Congress passed the Foreign Earned Income Act of 1978. The Tax Reform Act of 1976 was delayed until tax year 1978 and was made optional for that year only (7:iii). In 1978 the taxpayer had the option to use a package of deductions based on excess foreign living cost and was required to use the deduction package in 1979 and beyond. The office of the General Council of the Department of the Air Force stated:

> The pricing contingency problems identified by your letter [Air Force Logistics Command/Directorate of Procurement Law (AFLC/JANO)] should be resolved by the new law [Foreign Earned Income Act of 1978] and the parties should be able to negotiate a fair and reasonable contract price without the necessity of a special clause [8].

The impact of the new law was to make the pricing contingency problems worse:

> The new legislation enacted in 1978 revised the concept of excluding certain income from US taxation. The $20,000 to $25,000 exclusions under the old law were eliminated. . . . In place of the exclusions, it introduced a series of deductions related to the excess living expenses of working abroad [13:3].

The tax burden for employers overseas was also supposed to be lessened by the Foreign Earned Income Act of 1978 but ". . . unfortunately the overall tax burden for most American employers has not significantly decreased--and in some cases it has increased [13:2]." The following is a list of the series of deductions that the 1978 Act allows:

1. Qualified schooling expenses
2. Qualified home leave
3. Transportation expenses
4. Qualified cost-of-living differential
5. Housing expenses

The two areas that have caused the most difficulty in contract negotiations are the cost-of-living differential and the housing expenses.

Cost-of-Living Differential

The Internal Revenue Service (IRS) defines the cost-of-living differential as:

> The amount by which the general cost of living in the foreign place where your tax home . . . is located exceeds the general cost of living for the metropolitan area in the continental United States having the highest general cost of living [20:4].

The cost-of-living allowance in the IRS 1978 Qualified Cost of Living Tables (20:5) bears little resemblance to the actual cost of living variations experienced by contractor employees overseas. The Organization Resources Counselors (ORC), a management consulting and research firm whose foreign tax compensation advice is used by many DOD contractors,[1] has demonstrated that the difference between the IRS estimate of cost-of-living overseas and the ORC estimate of cost-of-living overseas can be substantial. An example of the differential will more clearly illustrate the problem. ORC's differential from New York City to Athens is $2,784 per year. The IRS differential from New York City to Athens is $300 per year. New York City has the highest cost of living of any U.S. city, and by law must be used by the IRS to compute cost-of-living differentials. (See Appendix A for a detailed explanation of ORC's differential.) ORC gives three arguments why the IRS differentials are unrealistic:

1. The U.S. dollar weakened significantly against many foreign currencies during 1978. The ORC figures reflect this movement; the IRS figures do not.
2. The ORC figures are based on more recent research than the IRS figures.
3. The ORC differentials are based on Washington, D.C., the practice normally followed by the private sector as well as the *U.S. Government* [italics mine] rather than the highest cost U.S. city [12:3].

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[1]McDonnell-Douglas, Lockheed, General Dynamics, and General Motors, who do the majority of overseas work for the 2750th ABW, use the ORC Guidelines as a basis for their proposal to perform services.

We make no assumptions about the validity of the ORC's arguments. The fact remains that the DOD contractors receiving most of the contracts (3) from the 2750th ABW use the ORC guidelines in compensating their employees and in turn prepare their price quotations to the government based on those figures. The contractors use the Washington, D.C., to Athens, Greece, ORC differential of $6696 per year as being the most realistic cost-of-living differential between the U.S. and Greece (see Appendix A).

Housing Expenses

The IRS defines housing expenses as the reasonable expenses paid for your housing during the tax year in a foreign country (20:7). The calculation of the housing expense has an unintentional built-in mechanism that assures that if an employee's actual and reasonable cost-of-living differential exceeds the amount allowed by the IRS, then the deduction for housing expenses will be less than it would have been had the employee not been paid a higher cost-of-living differential than the IRS allowed as a deduction. ORC stated that:

> The calculation of the base housing amount is complex. It is 20 percent of the employee's earned income [after deducting] the sum of actual housing expense, the cost-of-living differential,[2] the education deduction, home leave travel, and hardship if applicable. . . . Since tax allowances to the employee[3] are

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[2]as determined by IRS.

[3]excess cost-of-living over and above the amount determined by IRS.

> considered taxable income, the base housing amount will normally increase over time, and the deduction for excess housing cost therefore will decline [13:4,6].

Using the previous example, an understatement of $6,396 ($6,696-$300) by the IRS for cost-of-living in Athens will mean that the employee has been paid $6,396 more for cost-of-living than the IRS will allow as a deduction. The $6,396 that the IRS does not allow will increase his income which will in turn increase his base housing amount. An increase in the base housing amount will lead to a decrease in the deduction the man can take for housing. A decrease in the deduction for housing will mean that some portion of that amount the man was given for housing will be taxed. So that the man's taxes abroad will not exceed the taxes he would have paid on his domestic income, the company will have to pay a tax allowance which itself is taxed. The pyramiding effect of having to pay a tax on the tax allowance is a complicating factor of the Foreign Earned Income Act of 1978 that has made the reaching of an agreement difficult for the AF and the contractor. ORC recommends that employers consult with professional tax counsel in regard to any income tax adjustment for expatriate employees (11:63). The benefit of tax counsel, if available, would also be of great assistance to the AF negotiator. In 1978 AFLC/JANO, the legal advisor for the 2750th ABW, requested that the Secretary of the Air Force General Counsel (SAF/GC) prepare tax negotiation instructions for DOD personnel to

use in negotiating tax compensation under the Tax Reform Act of 1976 (5:3). SAF/GC replied that a new tax law, the Foreign Earned Income Act of 1978, was passed that should resolve the pricing contingency problems experienced on CETS contracts (8). As we have demonstrated above, the tax problem was by no means solved by the passage of the Foreign Earned Income Act of 1978. The data in Table I-1 were gathered from all the contractor proposals currently assigned to two negotiators selected at random within the 2750th ABW/PMT. Column 2 is the proposed tax allowances requested by CETS contractors using the provisions of the 1978 Act and the base salaries as proposed in column 1. Contract negotiators are responsible for negotiating fair and reasonable contract prices, including tax allowance. But the 2750th ABW does not have at its disposal tax counsel familiar with the Foreign Earned Income Act of 1978. Tax negotiation instructions like those AFLC/JANO requested after the passage of the Tax Reform Act of 1976 will be needed all the more to help the AF negotiate tax compensation under the Foreign Earned Income Act of 1978. It does not appear that such guidance will come from the SAF because the novelty of the problems caused by the Foreign Earned Income Act of 1978 have not yet been fully realized.

Problem Statement

The Foreign Earned Income Act of 1978 has created a new and complex problem for the AF because contractors

TABLE I-1

PROPOSED SALARIES AND INITIAL TAX ALLOWANCES (4; 14)

	(1) Yearly Base Salary	(2) Initial Tax Allowance
Wiesbaden, Germany	$23,500	$14,086
Lakenheath, U.K.	25,500	12,060
Zaire	24,752	3,989
Sudan	24,586	4,150
Norway	20,082	16,325
Denmark	20,812	16,343

are now requesting compensation for the excess income taxes of employees working abroad. AF contracting personnel cannot evaluate the reasonableness of the compensation requested without tax negotiation instructions.

Justification for Research

Contract negotiators for the AF have a variety of educational backgrounds and job experience. To accomplish their jobs, they rely on the technical assistance of engineers, the legal opinions of lawyers, cost accounting advice of price analysts, and a myriad of DOD regulations all aimed at the award of a contract. The contract negotiator's job, therefore, is to specialize in the art of contracting. The contract negotiator does not have the time, nor should he be expected, to become an expert on taxes.

Yet, the contract negotiator is charged with spending AF dollars wisely and without waste.

AFLC/JANO has stated that the tax issue "amounts to a significant dollar cost to the U.S. Defense contractors, the U.S. Air Force, and FMS customers and should be faced head-on. . . [5:4]." To face the problem head-on the contract negotiator needs guidance on how to establish the AF objective for negotiations.

Research Objective

The purpose of this study was to prepare a definitive DOD pricing instruction for pricing tax compensation for contractor personnel involved in AF and FMS contracts overseas. To accomplish this task, the following objectives were established:

1. To propose guidance that will provide the AF negotiator with the AF position on foreign taxes.

2. To consolidate the information provided to the individual taxpayer by the IRS into a format that can be used for negotiation.

Research Questions

To fulfill the objectives of this research, the following research questions were postulated:

1. Can general AF guidance on foreign earned income taxes be developed that will apply to contract negotiations?

2. Can the tax guidance published by the IRS be consolidated to make it understandable to the contract negotiator?

Scope

This research effort was limited to providing general guidelines such as those in the Defense Acquisition Regulation (DAR). The guidelines do not cover every possible tax compensation situation that may arise, but will leave it to the contract negotiator to adapt the guidelines to fit the negotiation situation. The guidelines are an easily readable document suitable for developing a negotiation position for foreign earned income taxes.

CHAPTER II

METHODOLOGY

Data Sources and Data Collection Plan

This research effort required data from two sources: DOD contracts and IRS publications. A generalized "contractor's compensation package" for employees abroad was defined. The data to accomplish this was gathered from current AF contracts. The IRS instructions that pertain to domestic and foreign earned income tax preparation were needed. IRS instruction was used to establish the excess income tax a representative contractor's employee would pay on foreign earned income over the income tax that he would pay on domestic assignment. The data to accomplish this were gathered from IRS publications.

Contract Data

The universe of contracts includes the service contracts written by all the military departments for services performed in foreign countries. Both AF and FMS service contracts are included in the universe. The population sampled for this research effort was the Fiscal Year 1979 (FY79) CETS contracts on file in the 2750th ABW Contracting Division. A census of all contracts over $100,000 was taken to determine how contractors compensate their

employees on overseas assignments. Defining a generalized "contractor's compensation package" required establishment of generic categories in which to place the various bonuses, cost-of-living allowances, subsistence and lodging payments, per diem, housing allowances and assignment pays that the major contractors include in their compensation packages.

IRS Publications

The IRS offers many publications for use by the individual in preparing personal income taxes. The population of interest for this research was those publications that apply to foreign earned income taxes. This research effort determined the hypothetical increase in taxes of the representative contractor employee abroad and not the real tax increase to each individual employee. Those publications which apply to the representative taxpayer in a contractor's pool of labor were selected. Publications used by the representative employee because he was in a labor pool and on contract (moving expenses and tuition overseas) applied. Publications used by the representative employee whether or not he was on contract (alimony payments and home energy credits) did not apply.

Data Analysis Plan

Data collected from the various contracts were separated into generic categories to establish a

representative compensation package. The representative package we developed was discussed with the contracting officers in the 2750th ABW Contracting Division to obtain their assessment of how well it represents the compensation packages of the major DOD contractors.

Data collected from the IRS publications were analyzed by the researchers to determine whether it could be used to compute the taxes on a representative employee's compensation package.

CHAPTER III

DOD CONTRACTOR EMPLOYEE TAXABLE INCOME

Introduction

Each DOD contractor has a unique employee compensation package. What is contained in the package at any point in time represents the current status of the agreement between company management and employees (and sometimes their unions) about what actually constitutes fair employee compensation. The simple notion of an employee's base salary as sole compensation has been greatly overshadowed recently by overseas compensation payments which, in some cases, can be one and one-half times the base salary (22:9).

In this chapter, base salary and common fringe benefits of DOD contractor employees will be discussed in their relationship to taxable income. Generic categories of taxable and nontaxable income will be listed separately. Income that is not considered to be related to the employee's actual performance on a DOD contract will be differentiated from income the employee is paid for performance on a DOD contract. Income that is felt to be <u>protected</u> against taxes will be so designated. By protected income we mean additional overseas compensation that exceeds any IRS allowable deduction but is considered

contractually fair and reasonable. The generic categories will be used in the next chapter to compute the DOD tax allowance.

Taxable Income

Presented and defined below are sixteen categories of taxable income that might be allocable to a DOD contract, domestic and/or overseas.

Base Salary

Base salary is the amount of income that the contractor pays the employee to perform a service in the contractor's plant or on an out-of-plant field assignment. Base salary should not include any additional compensation for field assignment work. Field assignment compensation should be proposed separately in one or more of the taxable income categories defined below. Base salary for the purpose of tax allowance computation should be treated on a contract period basis. The salary should include vacation, sick and holiday (VSH) pay in it. Different contractors will propose salary on a monthly, weekly, daily, or hourly basis.

Monthly salary can be converted to yearly salary by multiplying it by 12 _if_ the base monthly salary has not been reduced to account for VSH pay which is accounted for in the contractor's overhead. Any amount that is removed

from base salary for accounting purposes should be added back in before the monthly to yearly calculation is made.

Base salary proposed on a weekly basis can be multiplied by 52 if the base salary represents the full forty-hour domestic workweek (i.e., includes VSH pay).

Base salary proposed on an hourly basis for a full eight-hour day should be multiplied by 2,088 (365 days less 104 weekend days time 8 hours/day). Adjustments to this figure should be made if the workday is other than eight hours and the workweek is other than five days.

If there is any doubt as to whether the amount proposed represents the full base salary, the contractor should be asked to clarify what the base salary is, in writing, to reduce the possiblity of a later misunderstanding. Domestic base salary is fully taxable to the employee and should not be tax protected when the employee is overseas.

In some cases, salary will include an amount for programmed overtime as will be discussed below. Base salary is also called base pay, direct labor, base compensation and employee pay.

<u>Overtime Pay</u>

Overtime pay may be considered in two ways:

1. "As needed" overtime during the course of the base salary year, the occurrence of which is random and

cannot be accurately predicted whether the employment is in-plant or on a field assignment.

2. "Programmed" overtime that includes overtime for a workweek in excess of the standard forty-hour U.S. workweek (i.e., Israel has a six-day, forty-five-hour workweek (16)).

Contractor employees are expected to work the host country workweek and they are paid programmed overtime to compensate them for working longer hours. Programmed overtime, thus, is really a part of base pay and should not be added to the overseas base salary for tax allowance computation purposes.

Overtime required in 1. above is random, both in the plant and in the field and is very difficult to predict in advance. Random in-plant and field overtime tend to cancel each other out and are best left out of any tax allowance computation. Overtime pay may also be called overtime premium. In fairness to the employee, base salary overseas should not be reduced below forty hours because the employee is in a country that works a shorter workweek (e.g., Greece has a six-day, thirty-six-hour workweek (16)) unless a lower base salary based on a less than forty-hour workweek is expected to be achieved during negotiations.

Shift Differential

In-plant shift differential, which includes and is sometimes referred to as night differential, is an amount

paid to the employee for working a shift other than the normal plant shift that is worked by the plant management. The second and third shifts can be considered as shifts "added to" the normal shift that is maintained for minimum plant operation. In-plant and field comparisons of shift work requiring differentials are difficult to make. In-plant second and third shift differentials might be paid to the employee for work as a foreman on the production line. When the same employee is sent to the field as a technical representative, he will most likely work the day shift of the host country. Adding in-plant differential to his hypothetical domestic tax calculation but adding nothing to his overseas compensation will tend to understate his tax increase when going overseas. This has the effect of turning an incentive for taking an undesirable second or third shift in-plant into a disincentive for taking an overseas field assignment. The in-plant/field comparison also becomes muddied when labor pools are used because some employees will go from second or third shift work in-plant to normal shift in the field and vice versa. Also, comparisons of domestic in-plant employees to overseas field employees ignores substantial compensation to domestic field employees who are on assignment to field locations within the U.S. Therefore, shift differential should not be included in the tax allowance computation. Compensation to domestic field employees will be discussed

later in overseas assignment pay, where a strong case will be made for making the assumption that all employees sent on <u>field</u> assignment overseas will come from <u>field</u> assignment in the U.S. and <u>not</u> from the plant.

<u>Domestic Assignment Pay</u>

Most domestic field service technical representatives begin their careers and receive their initial training at the home plant of the contractor. Learning the technical aspects of the system is facilitated by hands-on experience acquired during the design, development, and/or production phases of the system. After gaining hands-on in-plant experience, the technical representative is better able to fill the role of a field representative. Field representatives that are trained at the home plant must necessarily, at some point in their careers, perform their duties in a location where the system is deployed with active U.S. forces. This assignment to the field activity is usually considered temporary and requires some sacrifice to the employee for which he is compensated by receiving an assignment pay. The amount of the pay varies from contractor to contractor but is usually set forth in the contractor's written policy and is available for examination by the Air Force Plant Representative Office (AFPRO) or the Defense Contract Audit Agency (DCAA). Arriving at a firm figure or a good estimate of how much the contractor

pays for domestic assignments is very important for making a comparison with overseas assignment pay, which will be discussed later.

A firm figure is easily attainable if the company policy pays a fixed dollar amount per year to any employee, at any salary range, for any domestic assignment. This is the case with one of the major DOD contractors (16). If the contractor pays different assignment pay amounts for different domestic locations but proposes direct labor for any location on an engineering category average, then the contractor should be requested to provide a good estimate of domestic assignment pay weighted by the number of employees at each location and divided by the total number of employees in the field. An example is shown in Table III-1. The mean domestic assignment pay is $5,677. On the rare occasion that an employee goes directly from domestic in-plant service to overseas field service, this mean assignment pay can be used for his hypothetical domestic tax computation. Otherwise, if no domestic assignment pay is added to the domestic calculation when the contractor normally pays it, the employee's tax allowance will be overstated and the contractor will receive a windfall.

If the employee comes from a domestic field assignment and the contractor cannot develop a mean assignment pay, then the employee's actual assignment pay should be used.

TABLE III-1

AN EXAMPLE OF MEAN DOMESTIC ASSIGNMENT PAY CALCULATION

Location	Assignment Pay/Year		#Men		Total
St. Louis	$4,680	x	5	=	$23,400
San Francisco	5,400	x	2	=	10,800
New York City	6,600	x	6	=	39,600
TOTAL			13		$73,800

$$\frac{\$73,800 \text{ Total assignment pay}}{13 \text{ Total men on contract}} = \$5,677 \text{ per man}$$

On some occasions, a DOD contractor will not have any employees on domestic field assignments with which to make a comparison with overseas assignments and base salary only must be used for making the tax computation.

The last major category of comparisons is the employee who goes from one overseas assignment to another overseas assignment. The method used above for making the initial tax computation (or if the overseas assignment was to a low-cost area, that method that would have been used had it been a high-cost area) should be used to calculate the tax allowance for the new overseas assignment. Table III-2 may be used as a quick reference for deciding which comparison method to use.

There are, of course, many other ways an employee may be hired and assigned to an overseas assignment: discharged from the Armed Services overseas and hired overseas,

TABLE III-2

DOMESTIC ASSIGNMENT PAY COMPUTATIONS

If domestic employees:	then for tax computation:
1. All get the same assignment pay for any domestic field assignment	1. Use that amount
2. All get different assignment pay for each location	2. Develop a mean assignment pay
3. Go directly from plant to overseas assignment	3. Follow procedures in 1 or 2 above as applicable
4. Come from field but no mean exists	4. Use actual field assignment pay
5. Come from plant but no actual or mean exists	5. Use base salary only
6. Go to one overseas assignment, then another	6. Use method 1-5 above that was used when employee first went overseas

hired from another contractor overseas, etc. The contract negotiator should apply the comparison method that he feels will result in the most fair and reasonable price to the government. Domestic pay is always taxable income and should be added to domestic base salary when computing the tax allowance. Domestic assignment pay is also called incentive pay, field incentive, out-of-plant incentive, and assigned bonus.

Overseas Assignment Pay

The sacrifices the employee makes that necessitate additional compensation in the form of domestic assignment pay are usually greater when the employee takes an overseas assignment. The amount may be expressed as a percentage of base salary or may be a fixed dollar amount per hour, day, month, or year. The amount may vary with the overseas location or may be the same for all overseas assignments. One contractor pays overseas employees the same assignment pay as the domestic employees but adds additional compensation such as auto allowance, hardship allowance, hazardous duty allowance and completion bonus, which will be discussed later (16). Employers who pay, for example, 10 percent of base salary for domestic assignment pay may pay 20 percent of base salary for overseas assignment but not pay other allowances or bonuses. Regardless of how the contractor calculates the overseas assignment

pay, it is taxable income to the employee and the amount which exceeds the domestic assignment pay should be tax protected under the contract. The reasons for protecting the excess are:

1. The employee may be thrown into a higher tax bracket because of high cost of living abroad and the amount left after taxes may not produce the incentive necessary to go overseas.

2. Not protecting the excess will encourage the employees to ask for higher and higher bonuses in the high-cost countries. Granting higher bonuses will encourage employees in low-cost countries to ask for comparable increases, thereby increasing cost on all contracts.

The problems associated with determining the amount of hypothetical domestic assignment pay do not exist when the assignment is overseas. Overseas assignment pay is a direct charge to the contract and is provided by the contractor on the DD 633. Overseas assignment pay should be added to overseas base salary when making the tax allowance computation. Overseas assignment pay is also called foreign assignment additive, overseas bonus, foreign incentive pay, foreign service allowance, and expatriot premium.

Domestic Subsistence and Lodging

The CETS program for AF is funded annually on a Fiscal Year (FY) basis, from 1 October through 30 September the following year. Most DOD contractors consider assignments of one year and a day to be long-term and assignments of 365 days or less to be short-term or temporary assignments (10). The employee's home is not moved on short-term assignments; the home base remains the contractor's plant and the employee is paid subsistence and lodging to offset the cost of maintaining a home away from home. The IRS considers the cost of maintaining a home away from home for purposes of employment an "employee business expense" and does not consider it taxable to the extent that it is not lavish and extravagant. Employees need only report "amounts [their] employer paid [them] for business expenses that are more than [they] spent for the actual business expense [19:10]."

We think it is tautological that the government would not pay the contractor and therefore the contractor's employee subsistence and lodging that was lavish and extravagant. Any amount paid to the employee would in turn be used by the employee to maintain a temporary home away from home for performance of the contract. Therefore, it is recommended that subsistence and lodging not be added to domestic base salary when making the hypothetical domestic tax computation.

Occasionally, a contractor will foresee that a long-term assignment is possible--even though funded annually--and will permanently relocate the employee to the domestic assignment and ask the government to pay the moving expenses. Again, the IRS considers the payment of reasonable moving expenses by the employer to be nontaxable and we feel the same rationale expressed above for not including subsistence and lodging in the domestic tax computation applies to moving expenses also. Subsistence and lodging is also called per diem.

Overseas Cost of Living and Housing Allowance

It is natural to assume, and interviews with contracting officers in the 2750th ABW/PMT verified, that contractor employees going overseas will try to maintain a standard of living as close as possible to that which they enjoyed in the United States (3; 10). Company-owned housing and company-run commissaries often were maintained by civilian contractors to maintain a reasonable standard of living for employees, but the trend has moved toward encouraging them to lease housing and live "on the economy" (11:133). DOD sometimes provides housing to unmarried contractor employees in the Visiting Officers Quarters (VOQ) but most employees are married (16) and must rent housing. DOD and State Department commissary privileges are available overseas at the discretion of the base

commander or the U.S. Embassy (16). However, even the use of the U.S. Government commissaries does not fully offset the cost of living overseas since some money must be spent on recreation, dining out, laundry, clothing, etc. on the local economy. Therefore, it is necessary for the contractor to pay his employee a cost-of-living allowance (COLA) and/or a housing allowance in those countries where the general cost-of-living and/or housing is higher than the cost-of-living or housing the employee was experiencing when he left the U.S. The government is asked to reimburse the contractor under the contract. The amount the employee needs is negotiated based on a comparison between the cost-of-living/housing in the U.S.[1] and the cost-of-living/housing in the overseas location. Describing the many methods (State Department indexes, ORC indexes, company indexes, actual employee experience, etc.) of arriving at the negotiated COLA and housing allowance is beyond the scope of this thesis. However, the assumption is again made that any allowance paid by the government under the contract to the contractor for the overseas employee is a fair and reasonable amount that accurately reflects the amount needed by the employee to maintain a reasonable standard of living. As will be explained in detail in the next chapter, we feel any allowance that the

[1]ORC uses Washington D.C. as a U.S. standard unless a special comparison is requested by the contractor using a different city in the U.S.

government gives the contractor for the employee to offset higher cost-of-living or housing should be protected from taxation. That is, if the amount exceeds the amount of exclusion that the IRS allows, as was explained in Chapter I, then the employee should be paid a tax allowance to offset taxes on the COLA or housing allowance.

Hardship Pay

Some overseas locations present a hardship to contractor employees in that living conditions are so bad that a standard of living close to that maintained by the employee in the U.S. is not possible. IRS states that

> A hardship area is a foreign place designated by the Department of State as a hardship post where extraordinarily difficult living conditions, notably unhealthy conditions or excessive physical hardships exist, and for which a post differential of 15% [of base pay] more would be provided to US Government employees [20:7]."

The IRS publishes the list of "Qualified Hardship Areas--Countries and Locations" in its Publication 54 each year. The IRS allows a deduction of $5,000 for qualified hardship areas which will be discussed in the next chapter. Of particular concern to contractor employees are the locations where the contractor pays a hardship allowance in excess of the IRS-allowed deduction of $5,000 or locations that the IRS does not consider a hardship area but the contractor's policy does. In either case, the hardship allowance--or excess hardship allowance--becomes taxable

income to the employee. Given that the contract negotiator for the government agrees to pay an excessive hardship allowance under the contract, we feel that the hardship allowance should be fully tax protected. The rationale for this position is that the government does not tax the hardship allowance of its own employees (15). The amount that is paid to the government's own employees is considered to be the amount necessary to compensate for the hardship; taxing the allowance would reduce its effectiveness. Taxing the hardship allowance of contractor employees would not only reduce its effectiveness, but would also encourage employees to ask for higher and higher allowance or would simply discourage employees from taking the assignments. Hardship allowances are also called special area allowances.

Hazardous Duty Pay

Some contractors give their employees hazardous duty pay when there is a known conflict in the overseas location (Vietnam, Israel, and Korea are examples) (16). The payment is analogous to the DOD's combat pay which is nontaxable to the government employee. Again, we feel that to maintain the effectiveness of the payment and to prevent the contractor's employees from demanding higher payments, that hazardous duty pay should be protected against taxes.

Auto Allowance

Upon initial assignment overseas, many contractor employees are given an auto allowance to help offset any loss they may have incurred when selling their auto in the U.S. The allowance will also help offset any excess cost of a replacement auto overseas because of higher prices and because the employee lacks time to shop around when arriving overseas. This allowance is taxable income to the employee.

On the other hand, employees on short-term assignment who are provided a rental car do not have to pay taxes on that portion of the rental that is used for business, as long as the rental cost is reasonable (15). We feel that, since a purchased auto on long-term assignment will be used and in some cases is necessary (10) to carry out the work assignment, that the auto allowance should be tax protected.

Further, regarding rental cars, the contract negotiator is precluded by government policy (10) from paying anything more than the fair and reasonable cost of car rental for government business use. Therefore, no cost of car rental overseas should need to be protected from taxes. If the employee incurs car rental expenses during his off-time, the cost is not incurred under the contract, is taxable, and is the employee's liability.

Completion Bonus

The government and the contractor recognize that, although the overseas requirements are funded annually, frequently services are required for longer than one year. It is to the government's benefit from a cost standpoint and the contractor's benefit from an administrative/logistics standpoint, not to bring every employee home at the end of each contract year. To minimize breaks in service, the contractor pays the employee a completion bonus for completing some predetermined period of service, usually two or more years. Since this payment is made to the employee <u>after</u> he returns to the U.S. and <u>after</u> the contract period has ended, it is not technically foreign-earned income. Also, we do not feel that employees would take or refuse an assignment because of the presence or absence of a completion bonus. Therefore, we feel that the bonus should be taxable to the employee as any end of the year bonus would be, and should not be tax protected under the contract.

Home Leave

Many contractors, as well as the U.S. Government, grant their employees a periodic leave to come back to the U.S. from an overseas assignment. Air fare and associated ground transportation are reimbursed by the contractor to the employee and then charged to the government. The CETS

policy is to pay up to coach air fare for travel (4). The payment to the employee is taxable in full. However, the IRS allows a deduction, once every continuous twelve months, for the "lowest reserved coach or economy rate that is offered, without advanced booking, on the day and at the time of day that the transportation is provided [20:6]." Any amount the employee pays for transportation in excess of what the government would normally reimburse under the contract should not be tax protected under the contract.

Schooling Expenses

Many contractors, as well as the U.S. Government, pay the cost of schooling expenses for their employees' dependents overseas. Contractor employees pay the expenses and request reimbursement from the employer. The government reimburses the expense. The reimbursement is fully taxable. Again, the IRS allows a deduction for "the cost of tuition, fees, books, local transportation, and other expenses required by a U.S. type school [20:6]." Any amount the employee pays for schooling expenses in excess of what the government would normally reimburse under the contract should not be tax protected under the contract since, by regulation, contractor employees are only reimbursed up to the cost of schooling expenses of the nearest U.S. type school (4). Schooling expenses are also called tuition allowance, schooling allowance, and simply education.

Moving Expenses

When a contractor's employee moves overseas, he will normally move his household goods with him. The contractor reimburses the employee for moving expenses in accordance with established company policy. In turn, the government is asked to reimburse the contractor up to the amount specified in the contract. Up to is stressed because the government does not always agree with the contractor's moving policy. Therefore, the contract amount reflects a fair and reasonable settlement between the contracting parties only. Nevertheless, all moving expenses paid to the employee are taxable income. The IRS allows a deduction for moving expenses paid or incurred by the employee in connection with starting work at a new principle place of work (20:27). Further, IRS states that "expenses that are more than a reasonable amount (determined by the circumstances of the move) may not be deductible [20:28]." The deductible expenses, explained in detail in Publication 54 include money spent on transportation, meals, lodging, movement of household goods, house-hunting trips and temporary quarters. We feel that the amount the government reimburses to the contractor's employee will, in the vast majority of cases, be sufficient to cover the reasonable cost of moving and that the employee will be allowed a full deduction of all moving expenses by the IRS.

Therefore, we recommend that moving expense income over and above the IRS allowed deduction not be tax protected under the contract.

Household Goods Storage

In some overseas locations it is impractical or impossible to move the contractor's employees' household goods (HHG). When the employee elects to store HHG in the U.S. while overseas, the government is asked to reimburse the cost of storage under the contract. Money given to the employee for storage of HHG is taxable income but the IRS allows a deduction for

> . . . storing the goods and personal items for part or all of the period that [the employee's] new place of work abroad continues to be [his] principle place of work [20:28].

As was stated in the discussion of moving expenses, we feel that the employee will be able to fully deduct all reasonable HHG storage income that he is paid under the contract and that any income he receives from the contractor that is over and above the IRS-allowed deduction should not be tax protected under the contract.

Miscellaneous Compensation

There are many other categories of compensation of small dollar amounts that the contractors pay their employees. Examples are relocation allowances, "key money" to start up a new rental home, language lessons, currency

adjustments, etc. The decision to protect these compensations from taxes rests with the contracting parties. Some general rules for the contract negotiator to follow are:

1. If the compensation is to be directly spent in performance of the contract, then it should be tax protected (passports, shots, etc.).

2. If the money is an incentive to get the employee to accept the assignment, then it should be tax protected (hardship allowance, hazardous duty pay, etc.).

3. If the money goes into the employee's pocket (completion bonus) or if it is more than is required to meet a reasonable need (excess moving expenses, first-class air fare, etc.), then it should not be tax protected.

Table III-3 is a summary of taxable incomes and recommends whether tax protection should be allowed or not.

Other Taxable Incomes, Deductions and Credits

There are many other taxable incomes, deductions and credits that individual contractor employees may have. The following list is not all-inclusive but is representative of the more common ones:

<u>Incomes</u>

Dividends
Interest
Rental Income
Capital gains

TABLE III-3

SUMMARY OF TAXABLE INCOME

Taxable Income	Tax Protection Recommended
1. Base Salary	No - Use same figure for domestic/overseas
2. Overtime Pay	No - Do not add programmed overtime to overseas base salary
3. Shift Differential	No - Do not add to domestic/overseas base salary
4. Domestic Assignment Pay	No - Add to domestic base salary
5. Overseas Assignment Pay	Yes - Add to overseas base salary
6. Domestic S&L	No - Do not add to domestic base salary
7. Overseas COLA and Housing	Yes - Add to overseas base salary
8. Hardship Pay	Yes - Add to overseas base salary
9. Hazardous Duty Pay	Yes - Add to overseas base salary
10. Auto Allowance	Yes - Add to overseas base salary
11. Completion Bonus	No - Do not add to overseas base salary
12. Home Leave	Yes - Up to IRS allowed deduction
13. Schooling Expenses	Yes - Up to IRS allowed deduction
14. Moving Expenses	Yes - Up to IRS allowed deduction
15. Household Goods Storage	Yes - Up to IRS allowed deduction
16. Miscellaneous Compensation	Yes - Add to overseas base salary unless excessive to employee's needs

Incomes

Royalties
Spouse's income
Other wages
Profit-sharing
Alimony received
Pensions

Deductions

Capital loss
Rental loss
Alimony paid

Credits

Political contributions
Child care
Residential energy

It is recommended that the above incomes, deductions and credits not be made a part of the tax allowance computation for these reasons:

1. The treatment of these items would violate the mean concept of pricing in that each individual employee's tax position would have to be negotiated.

2. The amounts that would be added or deducted from income would be almost impossible to predict in advance for purposes of writing a firm fixed price contract. Even if the amounts could be accurately predicted, the calculations of, say, a twenty-man CETS team, would be tedious.

3. To the extent some employees would have more deductions and credits than other incomes, others would have more other income than deductions and credits; the net effect would be that deductions and credits would wash out

other incomes. It would be left to the contractor to protect those employees with higher than pool incomes and prevent windfalls to those with major deductions and credits.

4. Finally, such incomes, deductions and credits are not properly allocable to a government contract.

In the next chapter we will demonstrate how the hypothetical domestic tax is computed and compare it with the expected overseas tax of a representative employee.

CHAPTER IV

THE ALLOWANCE COMPUTATIONS (DOD)

As stated earlier, the amount of income tax an employee must pay while on overseas assignment may greatly exceed his domestic assignment taxes even though the employee is maintaining the same standard of living overseas that he had in the U.S.

In this chapter, models will be developed to compute the taxes for a representative contractor employee, both domestic and overseas. A generalized example will be presented which the contract negotiator can use as a guide to developing Air Force objective tax allowances on actual contractual actions. This tax allowance will be computed as the difference between estimated overseas tax and estimated hypothetical domestic tax.

Hypothetical Domestic Tax Computation

The basic elements that make up the hypothetical domestic tax computation are: (1) base salary, (2) domestic assignment pay, (3) personal exemptions, (4) the itemized deduction estimate, and (5) state income tax avoidance. Base salary and assignment pay were discussed in Chapter III. Personal exemptions, the itemized deduction estimate and state income tax avoidance must be defined and estimated

before a generalized model for computing domestic taxes can be developed.

Personal Exemptions

The current deduction from income that the IRS allows per exemption is $1,000 (11:1). The contract negotiator and the contractor can arrive at an estimate of the number of personal exemptions in a number of ways. On a small contract the contractor should be asked to supply data on the actual number of exemptions expected to be claimed. This should not be considered privileged taxpayer information because the employee will most likely be moving his immediate family at government expense and will be certifying to the government the number of air fares for reimbursement, thereby indicating the number of family members. Also, COLA and housing allowances which are negotiated on a fixed price basis by the government are based on family size in addition to income level.

On large contracts the contractor should be asked to provide an estimate of the number of exemptions his total overseas workforce is expected to claim. Computerized personnel systems should be able to produce this information readily.

If no estimates exist, then the standard four-member family (husband, wife, two children) should be used. Recent census data indicate that this unit represents only

15.7 percent of households[1] but some contractors still use it (17:45). It should be noted that estimating a large number of exemptions lowers personal income tax and correspondingly any negotiated contractual compensation. Since the progressive income tax increases at an increasing rate (as will be shown in Chapter V) each additional dollar reduction in both domestic and overseas income will produce greater tax savings.

As illustrated in Table IV-1, the domestic tax drops only $480 ($2,745-$2,265) while the overseas tax on the higher income drops $860 ($9,366-$8,506) when exemptions are increased from two to four. The employee only needs an allowance of $6,241 rather than $6,621 when the exemptions are increased. The reduction of $380 ($6,621-$6,241) in the tax allowance is realized because, in higher tax brackets, taxes decrease at a faster rate than in lower tax brackets for each dollar that income is reduced. It can be shown that six exemptions produce a net tax reduction of $900 over two exemptions. Where an increase from two to four exemptions reduces taxes by $380, an increase from four to six exemptions reduces taxes $520 and so on.

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[1]One-member families are 22 percent of households; two-member families are 30.7 percent of households, and three-member families are 17.2 percent of households.

TABLE IV-1

IMPACT OF INCREASED PERSONAL EXEMPTIONS
ON TAXABLE INCOME

Example 1--2 Exemptions

	Domestic	Overseas
Gross Income	$20,000	$40,000
Number of Exemptions 2 x $1000	2,000	2,000
Taxable Income	$18,000	$38,000
Tax from Schedule Y, Form 1040	$ 2,745	$ 9,366

Example 2--4 Exemptions

	Domestic	Overseas
Gross Income	$20,000	$40,000
Number of Exemptions 4 x $1000	4,000	4,000
Taxable Income	$16,000	$16,000
Tax from Schedule Y, Form 1040	$ 2,265	$ 8,506

Tax Allowance Computation

	2 Exemptions	4 Exemptions
Overseas Tax	$9,366	$8,506
Domestic Tax	2,745	2,265
Tax Allowance	$6,621	$6,241

Itemized Deductions

In 1979, the IRS allowed standard deductions to income (now called the zero bracket amount) of $2,300 for single taxpayers and $3,400 for married taxpayers. By itemizing deductions for such personal expenses as medical and dental bills, taxes paid, interest, and donations, the taxpayer can further reduce his income if he has itemizable expenses greater than the zero bracket amount.

One contractor (22:8) calculates an imputed itemized deduction of 15 percent of base salary and uses the greater of that amount or the zero bracket amount in tax computations. For single employees, the break-even point between the $2,300 zero bracket amount and a 15 percent itemized deduction is $15,333 ($2,300 ÷ .15). If the base salary of a single employee exceeds $15,333, the imputed amount will increase the deduction and consequently lower taxable income. The break-even point for married employees is $22,667 ($3,400 ÷ .15). A higher imputed itemized deduction applied to both overseas and hypothetical domestic tax computations will produce a smaller tax allowance because of the nature of the progressive income tax (see Chapter V).

State Income Tax Avoidance

We did not have the time nor the manpower to investigate the savings in state income taxes that an

employee would enjoy by going overseas. However, we do feel that the tax dollars the employee avoids are worth the attention of the contract negotiator. The best source of information on state taxes is the contractor. The negotiator should ask the contractor to provide an estimate of the state tax avoidance using the employee's or the mean base salary and the home state of the contractor's plant. The home state of the plant should be used because it is normally used for comparison purposes when the contractor is sent on a field assignment (16). The assumption is that employee base salary is determined by the cost of living, taxes, and other factors near the plant. Since most contractors treat field assignments funded for 365 days or less as temporary and therefore consider the state the plant is located in as the employee's home state, then contractors should also accept the home state of the plant as a basis for computing state income tax avoidance. The amount that is computed for state income taxes should be added to the hypothetical domestic tax computation; this is the total hypothetical income taxes the employee would have to pay on domestic assignment. No state income tax need be added to the overseas tax computation unless the state taxes its residents while overseas, as Maryland does (10).

Hypothetical Domestic Tax Computation Model

To compute the hypothetical domestic income tax for 1979, the negotiator needs a 1979 Federal Income Tax Form 1040, Schedule TC, and the 1979 Tax Rate Schedules X and Y. Schedule X is for single taxpayers; Schedule Y is for married taxpayers.

The worksheet for married taxpayers in Figure IV-1 may be substituted for the Form 1040 and Schedule TC once the negotiator is familiar with how the tax computation is made. With slight adjustments, the worksheet can be used for single taxpayers.

The following example is a hypothetical domestic tax calculation for Bobby Buckeye. He is married, has two school-aged children and works for a contractor based in Columbus, Ohio who pays him a salary of $22,000 per year. He is presently on a field assignment in Nevada but will go overseas to Bitburg, Germany on 1 January 1979. His assignment pay in Nevada is $90 per week. We will use the tax worksheet in Figure IV-2 to arrive at a hypothetical domestic tax had Mr. Buckeye stayed in the U.S. for tax year 1979. In this example, the contractor has agreed to use Ohio as a home state for computing state income tax avoidance and has provided the state tax estimate of $380. Mr. Buckeye's hypothetical domestic tax is $4,347 per year. Mr. Buckeye's base income did not exceed the break-even

1.	Base Salary (Less portion of imputed itemized deduction of ___% of base salary greater than $3400)	$ ____________
2.	Assignment Pay	+ ____________
3.	Miscellaneous Income related to the employee's effort on the contract	+ ____________
4.	Adjusted Gross Income	$ ____________
5.	Personal Exemptions ______ x $1000	- ____________
6.	Taxable Income	$ ____________
7.	Tax from Schedule Y computed on Schedule TC	$ ____________
8.	State Tax Avoidance	+ ____________
9.	Hypothetical Domestic Income Tax	$ ____________

Fig. IV-1. Hypothetical Domestic Tax Computation (Married)

1.	Base Salary	$	22,000
2.	Assignment Pay $90 x 52 weeks	+	4,680
3.	Miscellaneous Income	+	-0-
4.	Adjusted Gross Income	$	26,680
5.	Personal Exemptions 4 x $1000	-	4,000
6.	Taxable Income	$	22,680
7.	Tax from Schedule Y	$	3,967
8.	State Tax Avoidance	+	380
9.	Hypothetical Domestic Income Tax	$	4,347

Fig. IV-2. Hypothetical Domestic Tax Computation (Bobby Buckeye)

point of $22,667 for imputed itemized deductions, so the zero bracket amount, already incorporated in Schedule Y, was used. Mr. Buckeye qualifies for four personal exemptions; one for himself, one for his wife, and one for each child.

Overseas Tax Computation

The basic elements of the overseas tax computation are:

1. Base salary

2. Overseas assignment pay

3. Other overseas income (including COLA, programmed overtime, housing allowance, hardship pay, hazardous duty pay, auto allowance, home leave, schooling expense, moving expense, HHG storage, and miscellaneous income

4. Personal exemptions

5. Itemized deductions estimate

6. Deductions for excess foreign living expenses allowed by the IRS (COLA, schooling expense, home leave transportation, hardship area amount, and qualified housing expenses)

Base salary, overseas assignment pay, other overseas income, and deductions for excess foreign living expenses were discussed in Chapter III. Personal exemptions and the itemized deductions estimate were discussed under the domestic tax computation section of this chapter.

Overseas Tax Computation Model

To compute the overseas tax for 1979, the negotiator will need IRS Publication 54; Form 2555, Deduction from, or Exclusion of, Income Earned Abroad, 1979; and Instructions for Form 2555, 1979, in addition to those forms and publications needed to compute the hypothetical domestic tax. The worksheet in Figure IV-3 may be substituted for the forms 1040 and 2555 and Schedule TC once the negotiator is familiar with how the tax computation is made. With slight adjustments, the worksheet can be used for single taxpayers.

The following example is the overseas tax calculation for Bobby Buckeye in Germany. His base salary remains $22,000 per year. His overseas assignment pay is $125 per week. The contractor uses a compensation arrangement similar to ORC to compensate his employee overseas. As stated in Chapter I, these amounts are generally higher than the IRS-allowed deductions. He is receiving the following allowances which the government will negotiate as part of the contract price:

COLA	$13,700
Schooling expenses	4,000
Housing allowance	8,000
Auto allowance	1,000
Moving expenses	8,000
Key money	500
Total	$35,200

As discussed in Chapter III, some expenses are completely deductible. We considered the moving allowance to be

1.	Base Salary (less portion of imputed itemized deduction of ___% of base salary greater than $3400)	$	________
2.	Overseas Assignment Pay	+	________
3.	Other Overseas Income	+	________
4.	Gross Income	$	________
5.	Deductions--Excess Foreign Living Expenses from Form 2555 (a) Qualified COLA $ ______ (b) Qualified Schooling Expenses $ ______ (c) Qualified Home Leave Transportation $ ______ (d) Qualified Hardship Area Amount $ ______ (e) Qualified Housing Expenses $ ______	-	________
6.	Adjusted Gross Income	$	________
7.	Personal Exemptions ___ x $1000	-	________
8.	Taxable Income	$	________
9.	Tax from Schedule Y Computed on Schedule TC	$	________

Fig. IV-3. Overseas Tax Computation (Married)

completely deductible since Mr. Buckeye was moved in accordance with the contract provisions. His allowances for tax computation purposes, therefore, are $27,200 ($35,200-$8,000). In Figure IV-4 we use the previously developed model to compute the overseas tax.

Mr. Buckeye's overseas tax is computed to be $6,889. The figures for line 1 through line 3 are arrived at in the same manner as in the domestic income model. Line 4 is gross income, which must be adjusted by the deductions in line 5 to arrive at adjusted gross income in line 6. The deduction in line 5(a) is taken from Table B on page 5 of IRS Publication 54. The IRS-allowed deduction of $9,700 for Germany is $4,000 less than the COLA that the contractor paid Mr. Buckeye. The schooling expenses deduction in line 5(b) of $4,000 equals the amount paid to Mr. Buckeye. The assumption is that he was only paid the actual and reasonable cost of schooling. The housing deduction in line 5(e) is arrived at by a series of calculations on lines 31 through 35 of the Form 2555. (See Publication 54 for an example of the use of Form 2555.) The negotiator should become familiar with the 2555 calculation before computing taxes using the worksheet. See Appendix B for a calculation of the housing deduction used in Figure IV-4.

Some explanation here, though, may be worthwhile. In Chapter 1, page 9, we stated,

1.	Base Salary	$	22,000
2.	Overseas Assignment Pay $125 x 52 weeks	+	6,500
3.	Other Overseas Income	+	27,200
4.	Gross Income	$	55,700
5.	Deductions--Excess Foreign Living Expenses from Form 2555 (a) Qualified COLA $ 9,700 (b) Qualified Schooling Expenses $ 4,000 (c) Qualified Housing Expenses $ 6,240	-	19,940
6.	Adjusted Gross Income	$	35,760
7.	Personal Exemptions 4 x $1000	-	4,000
8.	Taxable Income	$	31,760
9.	Tax from Schedule Y Computed on Schedule TC	$	6,889

Fig. IV-4. Overseas Tax Computation (Mr. Buckeye)

> An increase in the base housing amount will lead to a decrease in the deduction the man can take for housing. A decrease in the deduction for housing will mean that some portion of that amount the man was given for housing will be taxed.

In our example the actual COLA is $13,700 and actual housing allowance is $8,000. Since the qualified COLA is $9,700, $4,000 less than actual, the deduction for qualified housing will be reduced by 20 percent ($4,000) = $800 (see Chapter I, page 8). This $800 adds to taxable income. The remaining difference between $8,000 actual housing and $6,240 qualified allowance is discussed in Appendix B. Lines 7 through 10 are arrived at in the same manner as in the domestic income model.

Tax Allowance

Mr. Buckeye's overseas taxes are expected to be $6,689 per year. His excess taxes for going overseas, then, is the difference between his domestic taxes ($4,347) and overseas taxes or $2,542 ($6,689-$4,347). The government can expect a tax allowance claim for the excess taxes from the contractor. As we pointed out in Chapter I, DOD guidelines state that:

> In establishing employee compensation, including overseas differential, the contractor would properly consider all expenses associated with foreign employment, including taxes. . . [21:69].

It has been recognized that the payment by the contractor of the bare difference between foreign and domestic taxes is not enough to satisfy the employee and fully compensate

him. The reason for this is that the initial tax allowance--$2,542 in Mr. Buckeye's case--is taxable income. When the employee is paid the initial tax allowance, he must be paid a second tax allowance on the initial tax allowance, and a third tax allowance on the second, ad infinitum. Eventually, after the sixth or seventh tax allowance, the additional tax allowance needed becomes small enough to ignore. The process of calculating the several tax allowances on the initial tax allowance, the subject of Chapter V, is called "grossing-up." In the next chapter, we will show that the grossed-up tax allowance for Mr. Buckeye's initial tax allowance of $2,542 is $4,098.

CHAPTER V

GROSSING-UP OF TAX ALLOWANCE

Recall from Chapter IV that the tax allowance is the difference between the taxes on overseas taxable income and domestic taxable income. To that amount is added the state tax avoidance, if there is any. In Mr. Buckeye's case, overseas taxes were $6,889. His hypothetical domestic taxable income was $22,680 with a federal income tax of $3,967 and a state tax avoidance of $380 for a total of $4,347 in hypothetical domestic taxes. Six thousand eight hundred eighty-nine less $4,347 produces a $2,542 tax allowance. By the use of example, we will show what will happen to Mr. Buckeye's tax duty if he is paid the initial $2,542 tax allowance and subsequent tax allowances until his excess taxes are minimal.

	Overseas	Domestic
Earned Income Before Allowances	$31,760	$22,680
Tax Allowance	2,542	--
Taxable Income	$34,302	$22,680
Tax From Schedule Y	7,830	3,967
State Tax Avoidance	--	380
Income Tax	$ 7,830	$ 4,347

Mr. Buckeye now has a tax duty of $7,830 overseas. His domestic tax, $4,347, does not change. The following calculations show the "shortfall" of overseas taxes Mr. Buckeye will have to pay after the hypothetical domestic tax and the first tax allowance are deducted from overseas tax:

Overseas Taxes		$7,830
Less Domestic Tax	$4,347	
First Tax Allowance	2,542	
Previous Overseas Tax	$6,889	$6,889
Shortfall		$ 941

By a shortfall, we mean the difference between the taxes on (1) an income plus an allowance(s), and (2) the taxes on the same income without an allowance. The shortfall of $941 is divided by the tax allowance of $2,542. This fraction coincides with the tax percentage of the tax bracket Mr. Buckeye is in, 37 percent (see Tax Rate Schedule Y in Appendix C). This tax bracket percentage will be used later to develop a general formula used by some contractors to compute the total tax allowance.

If Mr. Buckeye is paid the $941 shortfall, his tax duty is calculated as follows:

	Overseas	Domestic
Earned Income Before Allowances	$31,760	$22,680
First Tax Allowance	2,542	--
Second Tax Allowance	941	--
Taxable Income	$35,243	$22,680
Tax	$ 8,180	$ 4,347

We repeat the shortfall calculation after the payment of the second tax allowance:

Overseas Taxes		$ 8,180
Less Domestic Tax	$ 4,347	
First Tax Allowance	2,542	
Second Tax Allowance	941	
Previous Overseas Tax	$ 7,830	$ 7,830
Shortfall		$ 350

The shortfall of $350 is divided by the second tax allowance of $941,

$$\frac{\$350}{\$941} = .3719$$

The percentage exceeds 37 percent, the original tax bracket, because the last $43 of the $941 tax allowance has put Mr. Buckeye into the lower part of the 43 percent tax bracket. If Mr. Buckeye is paid $350 shortfall, his tax duty is calculated as follows:

	Overseas	Domestic
Earned Income Before Allowances	\$31,761	\$22,680
First Tax Allowance	2,542	--
Second Tax Allowance	941	--
Third Tax Allowance	350	---
Taxable Income	\$35,593	\$22,680
Tax	\$ 8,331	\$ 4,347

Repeating the shortfall calculation:

Overseas Taxes		\$ 8,331
Less Domestic Tax	\$ 4,347	
First Tax Allowance	2,542	
Second Tax Allowance	941	
Third Tax Allowance	350	
Previous Overseas Taxes	\$ 8,180	\$ 8,180
Shortfall		\$ 151

The shortfall of \$151 is divided by the third tax allowance of \$350.

$$\frac{\$151}{\$350} = .4314 \text{ (.0014 error due to rounding)}$$

Each new dollar of income Mr. Buckeye is paid is now fully in the 43 percent tax bracket. Repeating the tax duty and tax shortfall calculations three more times we get the following:

Third Tax Allowance Shortfall	\$151
Fourth Tax Allowance	\$151

Fourth Tax Allowance Shortfall	$ 65
Fifth Tax Allowance	$ 65
Fifth Tax Allowance Shortfall	$ 28
Sixth Tax Allowance	$ 28

The final calculation of Mr. Buckeye's taxes and shortfall after paying the fourth, fifth, and sixth tax allowances are:

	Overseas	Domestic
Taxable Income Before Allowances	$31,760	$22,680
First Tax Allowance	2,542	
Second Tax Allowance	941	
Third Tax Allowance	350	
Fourth Tax Allowance	151	
Fifth Tax Allowance	65	
Sixth Tax Allowance	28	
	$35,837	$22,680
Tax	$ 8,436	$ 4,347

Overseas Taxes	$ 8,436	$ 8,436
Less Domestic Tax	4,347	
First Tax Allowance	2,542	
Second Tax Allowance	941	
Third Tax Allowance	350	
Fourth Tax Allowance	151	
Fifth Tax Allowance	65	
Sixth Tax Allowance	28	
Overseas Taxes	$ 8,424	$ 8,424
Shortfall		$ 12

We will add the $12 shortfall to the overseas tax of $8,424 without calculating any further taxes or shortfalls. The total tax allowance needed is $8,436 less domestic tax of $4,347 which is $4,089. At this point we will consider the subsequent allowances and shortfalls negligible and leave this tedious example to develop a general model for grossing-up proposed by some contractors. We will show that this general model also has shortcomings.

General Grossing-up Formula--The TPCD

We will introduce the general grossing-up formula by posing the question: What gross-up tax allowance must be paid at a given tax percentage to protect an initial tax allowance paid to an employee in that tax bracket? For a simplified example to answer the question we will

use an initial tax allowance of \$5,000 and a tax bracket percentage of 25 percent.

The tax allowance of \$5,000 is paid to the employee and is taxable. To protect the \$5,000 from taxes, 25 percent more in additional tax allowance must be paid--.25(\$5,000) or \$1,250. To protect the \$1,250, 25 percent more in additional tax allowance must be paid--(.25)(.25)(5000) or \$312.50.

This process theoretically continues indefinitely. For practical purposes we will denote by n a number sufficiently large (generally 6 or 7) that continuing the process to get additional tax allowances, results in an immaterial addition. The formula on \$5,000 at a 25 percent bracket percentage is:

$$\$5{,}000 + (.25)(5000) + (.25)(.25)(5000) + (.25)(.25)(.25)(5000) + \ldots + (.25)^n(5000) = \$6{,}666.67$$

or

$$[1 + (.25) + (.25)^2 + (.25)^3 + \ldots + (.25)^n]\ [5000] = \$6{,}666.67$$

Using the process described earlier in this chapter, repeated iterations of tax allowances and shortfalls calculates a tax allowance of \$6,667. Therefore, the grossed-up tax allowance to protect an initial tax allowance of \$5,000

in a 25 percent bracket is \$6,667. From this example we develop the general formula:

$$[1 + \text{bracket} + \text{bracket}^2 + \text{bracket}^3 + \ldots + \text{bracket}^n] \times [\text{initial tax allowance}] = \text{grossed-up tax allowance}$$

where again, n is sufficiently large as to materially complete this grossing-up process. In our example with an initial tax allowance of \$5,000 that resulted in a grossed-up tax allowance of \$6,667, note then by our large n assumption:

$$6667 = [1 + (.25) + (.25)^2 + \ldots + (.25)^n][5000]$$

Multiplying both sides by .25,

$$.25(6667) = [.25 + (.25)^2 + \ldots + (.25)^{n+1}][5000]$$

adding in the \$5,000 and subtracting it out again,

$$.25(6667) = [1 + .25 + (.25)^2 + \ldots + (.25)^{n+1}][5000] - 5000^*$$

By our large n assumption,

$$6667 = [1 + .25 + (.25)^2 + \ldots + (.25)^{n+1}][5000]$$

so, substituting 6667 in the first half of the right side of *

$$
\begin{aligned}
.25(6667) &= 6667 - 5000 \\
-6667 + .25(6667) &= -5000 \\
-1 + .25(6667) &= -5000 \\
6667 &= \frac{-5000}{-1+.25} \\
6667 &= \frac{5000}{1-.25}
\end{aligned}
$$

So,

$$\text{grossed-up tax allowance} = \frac{\text{initial tax allowance}}{\text{1-tax percentage}}$$

The general gross-up formula, then, is the ratio of the initial tax allowance divided by the complement of the tax bracket percentage. We call this the Tax Percentage Complement Divisor (TPCD) formula.

We will now use the TPCD formula on our previous example of Mr. Buckeye, whose initial tax allowance was \$2,542 and whose initial tax bracket was 37 percent.

$$\frac{\$2,542}{1-.37} = \$4,035$$

But we found that the actual grossed-up tax allowance from the calculation at the beginning of this chapter to be \$4,089. The difference of \$54 is attributed to Mr. Buckeye's income jumping into a higher bracket (43 percent) after the tax gross-up calculations began. Recall that all the calculations and the derivation of the TPCD formula assumed no change in tax bracket.

We state without further proof that any tax gross-up amount arrived at using the TPCD formula will accurately predict the tax gross-up if the tax bracket does not increase and will always understate the tax allowance if the bracket does increase. The closer the income plus the initial tax allowance is to the top of the initial tax bracket, the greater will be the understatement of the tax allowance. This is true because the progressive income tax is based on a series of tax brackets, each with an individual formula.

Tax Bracket Formulae

Schedule Y, reproduced in Appendix C, is made up of fifteen tax brackets. Each tax bracket is associated with a range of income and has a different tax computation equation. For example, the equation for the income range over \$11,900 but not over \$16,000 is

$$Y_{.21} = \$1404 + .21\ [X - \$11{,}900]$$

where

Y is the tax amount

.21 is the tax bracket percentage

\$1,404 is the tax on \$11,900

X is income $\$11{,}900 < x \leq \$16{,}000$

The equation for the income range $\$16{,}000 < x \leq \$20{,}200$ is:

$$Y_{.24} = \$2,265 + .24\ [X-\$16,000]$$

In a graph of the first eleven tax brackets in Figure V-1, we see that the effective tax rate, i.e., the total tax on total income, is a series of straight lines. Each bracket between the first and last intersects with the brackets before it and after it and the equations of the bracket lines are equal at those points. The brackets become longer and the slopes become steeper as income increases. Again, any tax gross-up formula, like the TPCD, that ignores the effect on taxes of jumping brackets, will understate the gross-up allowance.

<u>Recommended Grossing-up Method</u>

Since using the TPCD method will always understate the tax allowance when crossing tax brackets, we are not advocating that the contract negotiator discourage those contractors who use the TPCD formula from doing so. Indeed, it is a quick check method to verify any grossed-up allowance for accuracy. However, we will present an easy and very accurate method to calculate the actual tax gross-up when crossing tax brackets. The negotiator will need to use this method to verify the tax allowance claimed by contractors using one of several other methods to gross-up that tape bracket increases into account.

Let us reconsider what we actually want to protect from taxes. We refer to net income after taxes. To be

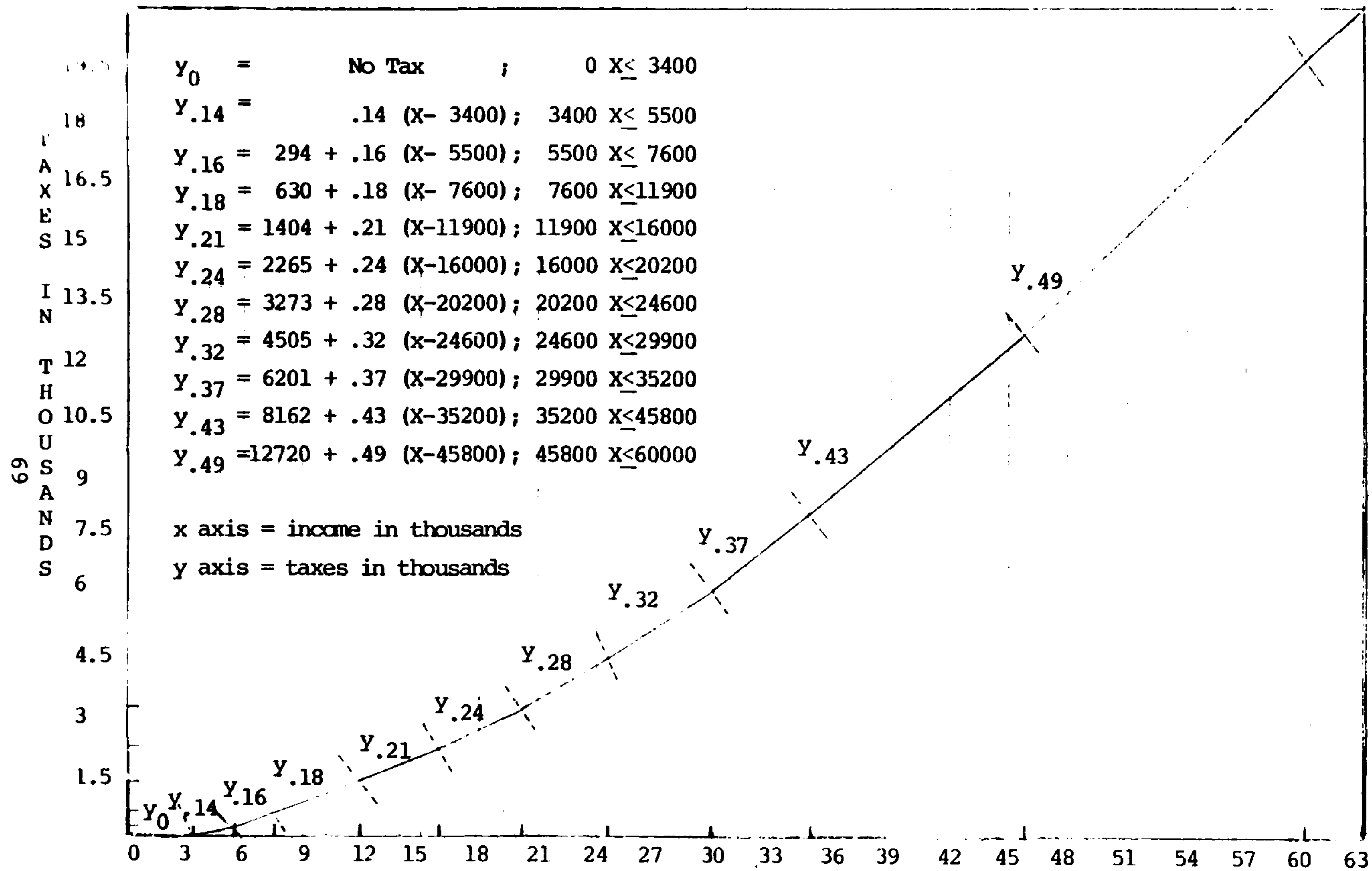

Fig. V-1. Effective Tax Rates

completely protected from excess taxes Mr. Buckeye must be paid a net income which is the sum of:

1. Net hypothetical domestic income. This is the difference of his adjusted gross domestic income of $26,680 (see line 4, Figure IV-2) and his hypothetical domestic income tax of $4,347. The net hypothetical domestic income must be protected from excess foreign taxes or Mr. Buckeye will be disincentivized to go overseas; he could retain more income by staying in the United States.

2. Actual increased expenses overseas. This is the difference of gross income overseas of $35,750 (see line 6, Fig. IV-4) and hypothetical domestic income of $26,680. The amount Mr. Buckeye is paid for increased expenses overseas must be protected on an after-tax basis if it is to be an effective incentive for getting Mr. Buckeye to go overseas. The reasons for protecting the individual elements that make up the increased expenses overseas were provided in Chapter III.

The total net income Mr. Buckeye must have <u>after</u> he has paid his taxes is computed as follows:

Hypothetical Adjusted Gross Domestic Income		$26,680
Less Hypothetical Domestic Income Tax		4,347
Net Hypothetical Domestic Income		$22,333
Adjusted Gross Income Overseas	$35,760	
Less Hypothetical Adjusted Gross Domestic Income	26,680	
	$ 9,080	$ 9,080
Net Income Needed After Taxes		$31,413

Before we compute any tax allowance, we must deduct $4,000 from this amount to account for Mr. Buckeye's four personal exemptions. Thus $27,413 is the true after-tax income Mr. Buckeye must receive. To arrive at the tax that is associated with after-tax income, we have taken Tax Rate Schedule Y for married taxpayers and broken the income ranges down into $100 increments (Appendix D, column A) and computed the tax (column B) on each increment. Column C is the after-tax income (column A - column B). We find that $27,413 in after-tax income is associated with a tax liability of $8,445 (interpolated). Since Mr. Buckeye is bound to $4,347 in domestic tax, his total grossed-up tax allowance is the difference or $4,098. This closely approximates the tax gross-up of $4,089 found at the beginning of this chapter and is more accurate because it does not stop at the sixth iteration and it does not carry forward rounding errors.

The tax gross-up worksheet in Figure V-2 can be used in calculating tax gross-up using the totals in Appendix D. Using the worksheet, we calculate Mr. Buckeye's tax gross-up in Figure V-3.

We will conclude this chapter by showing how the chart in Figure V-3 calculates the grossed-up tax allowance which we computed by several iterations of allowances and shortfalls at the beginning of the chapter. The explanation given earlier to justify the chart and the chart itself are probably more intuitively perceived than any formal demonstration. A formal demonstration is, however, necessary for the completeness of the chapter.

1. In lines 6 through 8 of the chart a tax is computed from the table in Appendix D (line 6), the domestic tax is subtracted (line 7), and the grossed-up tax allowance is the difference (line 8).

Recall that at the beginning of the chapter we defined a tax allowance as the difference between overseas taxes and domestic taxes. Adding a tax allowance to earned income increased income and, correspondingly, overseas taxes, leading to an additional tax allowance. This process continued until the shortfall, the difference between the <u>taxes</u> on the sum of income plus previous allowances, was materially the same as the taxes on the sum of overseas income plus previous allowance plus the next allowance. The sum of the allowances is the grossed-up tax allowance.

1.	Domestic Adjusted Gross Income (Line 4, Figure IV-2)	$	____________
2.	Less Hypothetical Domestic Income Tax (Line 9, Figure IV-2)	-	____________
3.	Subtotal	$	____________
4.	(a) Plus Adjusted Gross Income Overseas (Line 6, Figure IV-4)	+	____________
	(b) Less Adjusted Gross Income Domestic (Line 4, Figure IV-2)	-	____________
	(c) Less Personal Exemptions (Line 5, Figure IV-2)	-	____________
5.	After Tax Income--Go to Column C, Appendix D	$	____________
6.	Tax from Column B, Appendix D	$	____________
7.	Less Domestic Income Tax (Line 2 above)	-	____________
8.	Grossed-up Tax Allowance	$	____________

Fig. V-2. Tax Gross-up Worksheet (Married)

1.	Domestic Adjusted Gross Income (Line 4, Figure IV-2)	$	26,680
2.	Less Domestic Income Tax (Line 9, Figure IV-2)	-	4,347
3.	Subtotal	$	22,333
4.	(a) Plus Adjusted Gross Income Overseas (Line 6, Figure IV-4)	+	35,760
	(b) Less Adjusted Gross Income Domestic (Line 4, Figure IV-2)	-	26,680
	(c) Less Personal Exemptions (Line 5, Figure IV-2)	-	4,000
5.	After Tax Income--Go to Column C, Appendix D	$	27,413
6.	Tax From Column B, Appendix D	$	8,445
7.	Less Domestic Income Tax	-	4,347
8.	Tax Allowance	$	4,098

Fig. V-3. Tax Gross-up Worksheet (Mr. Buckeye)

This grossed-up tax allowance can then be characterized as the difference between the final overseas tax (overseas taxes on sum of overseas income plus the grossed-up tax allowance) and domestic tax. So if we can show that the tax on line 6 is this final overseas tax, then it is clear that the tax allowance on line 8 of the chart is the same as the grossed-up tax allowance computed at the beginning of the chapter.

2. Lines 1 through 5 of the chart are algebraically equivalent to overseas taxable income less domestic taxes. To see this, note that exemptions are completely added and subtracted. What remains is just overseas taxable income less domestic taxes. So, to complete the demonstration that the grossed-up tax allowance of line 8 is the same as computing several allowances and shortfalls until the result is negligible, all that remains is to show that overseas taxable income less domestic taxes is the same as overseas after-tax income (overseas net income). Then, after this is shown, line 6 is final overseas tax and from 1. above the demonstration is complete.

To begin, then, overseas net income is overseas taxable income plus grossed up tax allowance less final overseas tax. (In symbols ONI=(OI+GTA)-FOT or ONI=OI+(GTA-FOT)). From 1. the final overseas tax less domestic tax is the grossed-up tax allowance (FOT-DT=GTA). This is equivalent to saying grossed-up tax allowance less final

overseas taxes is the negative of domestic taxes (GTA-FOT= -DT). Substitute this in our overseas net income formula [ONI=OI+(GTA-FOT)], and get (ONI=OI-DT); i.e., overseas after tax-income is the same as overseas taxable income less domestic taxes.

This completes the demonstration that grossed-up tax allowance as computed at the beginning of the chapter is the same as derived on line 8 of the chart.

CHAPTER VI

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

Research Objectives

The objective of this research was to prepare a definitive DOD pricing instruction for computing a tax allowance on AF and FMS contracts overseas. Two research objectives were identified:

1. To establish guidance for the AF negotiator regarding the AF position on taxes.

2. To provide IRS information on taxes in a format that could be used by the AF negotiator during negotiations.

Regarding the first objective, we feel that the basic guidance we have provided is sufficient to cover the majority of the negotiation situations the AF negotiator will encounter. The guidance was written around actual contract data on hand in the 2750th ABW and included data from all the major AF contractors. Intuitively, we feel that the compensation packages for the contract employees of the other DOD departments and the other agencies and departments of the federal government should not differ greatly from AF contractor compensation packages. In the event a particular government contractor has a unique compensation

arrangement, we have provided guidance in Chapter III. This guidance will help classify other taxable incomes, deductions and credits so that unique items of compensation can be integrated into the general tax allowance computation model. Therefore, we feel that any government department could readily adapt the guidance we provided to fit its own needs.

To meet our second objective, in Chapter IV we developed easy to use tax worksheets for married employees who remain overseas long enough to qualify for the IRS-allowed exclusions from income. Several assumptions were made to allow for the development of a simplified tax computation model:

1. The employee was married and filing a joint return.

2. The employee remained overseas the specified length of time to qualify for deductions.

3. The employee did not live in a hardship camp or maintain a second household overseas.

We feel the above assumptions are minor enough and their effects, if felt, are infrequent enough to not invalidate the usefulness of the basic model. However, as we will discuss under the recommendations section of this chapter, we feel further study is warranted to develop guidance

to cover the effects if one or more of the assumptions are not met.

Research Questions

Research question one, which asked whether AF guidance on foreign earned income taxes could be developed that would apply to contract negotiations, is answered in the affirmative. We feel that any AF CETS negotiator in the 2750th ABW should be able to use the tax guidance in Chapters IV and V and develop an AF objective for tax compensation. However, we will offer strong reasons in the last part of this chapter as to why the negotiator should not personally be required to compute tax allowances.

Research question two, regarding the feasibility of consolidating the IRS guidance necessary to compute tax compensation and the possibility of making it understandable to the nonaccountant negotiator, is also answered in the affirmative. However, the negotiator cannot use the tax guide alone without some rudimentary understanding of the IRS Forms 1040 and 2555 and Publication 54. There is no quick and easy way to learn about taxes without some effort on the part of the negotiator. Whether or not the negotiator should be required to become proficient in tax negotiations will be addressed in the recommendations portion of this chapter.

Grossing-up

Finally, we identified a phenomenon of contractual tax allowance computation not addressed in the basic employee compensation package or the IRS publications: grossing-up of the tax allowance. The necessity of grossing-up the initial tax allowance can substantially increase the final amount needed to compensate the employee; the amount needed grossing as the tax bracket is increased. The impact of the new element of contractor cost called tax compensation will be discussed later as it affects both the DOD budget and FMS customers' budgets.

Recommendations

DOD Actions

ORC has lobbied Congress and the IRS on behalf of the contractors that are its customers in an attempt to repeal or liberalize the Earned Income Tax Act of 1978. We feel that DOD should do the same for its departments and the FMS customers it serves. We recommend that DOD look into all overseas service contracts (as well as supply and production contracts with overseas services) to determine the real impact of the 1978 Act on the DOD budget and those budgets of its FMS customers. Funds that are budgeted for defense but that eventually accrue to the IRS and the Treasury do not directly enhance the capability of our defense or that of our allies. To that end, DOD should recommend that contractor employees

on government contracts be treated as if they are U.S. Government employees, and that all allowances that are negotiated as fair and reasonable for contract performance be tax exempt if similar allowances are tax exempt to government employees. If DOD contractor employees cannot be exempted from the Act, then at least Congress should be lobbied to change the cost comparison city from New York City to a median cost city for IRS COLA computation. This change alone--and the impact it would have in increasing the housing deduction--could substantially reduce the tax allowance. How much it would reduce the allowance would depend on which U.S. city was finally chosen to make the comparison.

AF Action

The 2750th ABW has suggested that tax allowance be made a reimbursable item; the amount to be settled at the end of the contract period (2). The benefits of this proposal would be that if the tax laws changed or if the employee's employment situation changed after the contract was written, the parties would be protected by negotiating the tax allowance after the extent of all changes had been assessed.

Another possiblity for relieving the negotiator from tax negotiations would be to make taxes an overhead

item. Discussions with DCAA as to the mechanics of this recommendation would be necessary.

AFLC Action

It was the general feeling of those persons we talked to in the 2750th ABW that the 1978 Act had greatly increased the workloads of the individual negotiators. Some felt that contract negotiators were not hired as tax experts and did not feel they should be required to develop the competence to negotiate tax allowances with firms that had hired accounting firms as foreign earned income tax consultants. AFLC should study the manpower impact of dealing with the 1978 Act and consider creating more price analyst positions or perhaps designating a "tax expert" slot for the 2750th ABW. As we will discuss below, someone knowledgable in the income tax area will have to assist the 2750th ABW on a periodic basis from now on and for as long as tax allowances are an item of negotiations.

2750th ABW Action

The tax laws of the U.S. are changed frequently. Several years ago the standard deduction was replaced by the zero bracket amount which was incorporated into the tax tables. A maximum $180 tax credit that was given in the 1978 tax year was dropped in 1979, causing a revamping of the TC schedule. Tax bracket ranges and tax percentages within the ranges change almost yearly; the

1979 brackets being different from the 1978 brackets. New tax deductions are added (storage of household goods) and old deductions are eliminated ($20,000 exclusion for foreign earned income).

Pending AFLC action, the CETS branch must designate a "tax expert" from among the negotiators or price analysts to keep up to date on the tax guide and the gross-up tables and to conduct training for contract negotiators. The 2750th ABW should investigate being placed on IRS mailing lists for current tax changes that would affect the individual's taxes and foreign taxes. We recommend the 2750th ABW develop a tax worksheet for inclusion in their Requests for Proposals (RFPs). We feel it is important for the AF to take the lead and to require the contractor to follow its tax policy rather than to allow each contractor to develop a different tax allowance formula.

Future Study

As we spent a great deal of time just learning about taxes, we unfortunately did not have the time to investigate the possibility of developing a comprehensive computer program for use by the negotiator or price analyst to arrive at the tax allowance objective. We feel a future thesis team could develop a program, and that a copper import terminal could be installed in the 2750th ABW pricing office for computing the tax allowance.

Also, as was mentioned earlier in this chapter, there are many nuances to the tax allowance computation that an expanded model or other models should include. For instance, single employees use Schedule X for computing their taxes. Our model assumed all employees are married. A supplement to the basic guide should be developed for single employees.

Employees who are on short-term assignments do not qualify for the deductions for COLA, housing, etc. Employees who live in hardship camps receive special tax consideration as do employees who maintain a second household overseas.

These and other special situations are not frequent problems to the negotiator but are nevertheless time-consuming and require special handling when they do arise. Expanded models could be developed to cover the most prevalent occurrences.

Finally, on the human issue side of the ledger, we don't think that contract negotiators should have to become tax experts. We feel they should be given tax advice just as they are given legal and cost/price advice from lawyers and price analysts. After talking to many CETS negotiators, we found that computing taxes is something that many negotiators do not even do for themselves. And it is not because they lack the mental capacity to understand and file the forms correctly. It is because

they will lose a refund or pay a penalty if they overlook a deduction or underpay their taxes. When dealing with their own money, many seek the advice of an expert in the field who is current on the tax laws.

We strongly feel the AF should do the same to assure that no more than is necessary of its budget goes from the treasury back to the treasury without contributing to the national defense.

APPENDICES

APPENDIX A

A LIST OF THE COST-OF-LIVING DIFFERENTIALS FOR 20 MAJOR FOREIGN CITIES CALCULATED ON THREE DIFFERENT BASIS

The chart on the following page shows a list of the cost-of-living differentials for 20 major foreign cities calculated on three different basis (12:2):

1. IRS Tables

a. Column 1 shows the allowable deductions for a family of four as proposed by the Service.

b. Column 2 lists the dates the Department of State conducted pricings at the foreign locations to derive the index numbers which were used as basis for the Column 1 deductions.

2. ORC Differentials as of December 31, 1978

a. Column 3 shows the differentials related to Washington, D.C., that ORC recommended on December 31, 1978, for families of four at base salaries of $32,442.

b. Column 4 displays the rates of exchange at which the Column 3 figures were calculated.

c. Column 5 shows the dates on which ORC overseas pricing agents conducted the surveys which served as basis for Column 3.

3. ORC Average Differentials for 1978

a. Column 6 has the averages of the ORC cost-of-living differentials in effect for families of four at salary levels of $32,442 related to the highest cost U.S. city on February 15, May 15, August 15, and November 15, 1978. The methodology for adjusting from Washington, D.C., to the highest cost city was identical with that used by the Department of State.

b. Column 7 lists the average rates of exchange used in the calculation of Column 6.

COMPARISON OF COST-OF-LIVING DIFFERENTIALS FOR AN AMERICAN EXPATRIATE FAMILY OF FOUR (12:Atch.B)
(Base Salary: $32,422 per Year)

	1.	2.	3.	4.	5.	6.	7.
	IRS		ORC Differentials as of 12/31/78[a]			ORC Average for 1978[b]	
Location	Allowable Deduction	Pricing Date	COL Differential	Rate of Exchange	Pricing Date	COL Differential	Rate of Exchange
Athens	$ 300	06/77	$ 6,969	DR 34.60	10/78	$ 2,784	Dr 36.35
Brussels	7,000	07/77	13,920	BF 29.30	04/78	9,864	BF 31.56
Buenos Aires	—	09/77	6,096	P 980.00	10/78	3,084	P 712.00
Caracus	4,600	08/77	5,796	Bs 4.30	10/78	3,240	Bs 4.30
Frankfurt	5,700	02/77	14,676	DM 1.93	05/78	10,620	DM 2.06
Geneva	7,000	05/77	17,544	SF 1.61	10/78	13,932	SF 1.82
The Hague	3,700	02/77	10,608	Fl 2.15	05/78	6,552	Fl 2.24
Hong Kong	1,700	02/77	4,740	HK$ 4.82	09/78	3,384	HK$ 4.67
Jakarta	2,300	03/77	1,824	Re 625.00	04/78	5,604	Re 415.00
Johannesburg	—	02/75	1,584	R .8679	10/78	—	R .8679
Kuala Lumpur	1,000	06/77	4,440	M$ 2.22	06/78	1,884	M$ 2.32
London	—	04/77	5,196	£ .505	06/78	2,640	£ .527
Madrid	300	07/76	3,984	Pta 74.00	05/78	1,284	Pta 79.33
Manila	—	12/76	528	P 7.33	04/78	—	P 7.37
Paris	4,600	03/77	9,108	FF 4.35	10/78	5,796	FF 4.57
Rome	300	09/77	4,440	Lit 833.00	04/78	1,584	Lit 857.00
Sao Paulo	1,000	03/77	3,984	Cr 20.00	09/78	1,884	Cr 17.03
Singapore	300	03/77	6,696	S$ 2.20	04/78	3,840	S$ 2.31
Sydney	1,700	10/77	5,040	A$ .870	08/78	2,340	A$ .875
Toronto	—	09/77	72	C$ 1.19	07/78	—	C$ 1.14

Note: Rates of Exchange are to U.S. $1.00.

[a] Based on Washington, D.C.

[b] Based on ORC tables of 02/15, 08/15, and 11/15, 1978 for highest cost U.S. City.

APPENDIX B

A CALCULATION OF THE DEDUCTION FOR FOREIGN HOUSING EXPENSES USING THE IRS FORM 2555

This appendix explains in some detail the computation for qualified housing expense using the data from Chapter IV (see Figure IV-4). The illustration on the next page is an excerpt of the Form 2555 (20:17) which deals with the Qualified Housing Expenses deduction.

On line 30, actual or assumed housing costs overseas must be entered. If actual overseas cost is not yet available, as in Mr. Buckeye's case, or is never individually documented, in the case of a mean housing allowance, then assumed housing costs must be calculated. We assumed Mr. Buckeye's housing to be $350 per month times 12 months or $4200 per year in Columbus, Ohio, the location of the contractor's plant. This assumed U.S. housing amount can be obtained from the ORC, the contractor's internal policy, the average for the city, etc. Adding to this $4200 domestic housing cost the $8000 housing allowance negotiated for the contract, we get assumed actual foreign housing expenses of $12,200. Since Mr. Buckeye previously paid the $4200 out of his salary, we assume this amount will still be paid out of his salary.

Line 31(a) is Mr. Buckeye's adjusted gross income from line 4 of the Overseas Tax Calculation in Figure IV-4. Lines 31(b)-31(h) are self-explanatory. Line 31(i) is 20 percent of line 31(h). This is called the base

Qualified Housing Expenses (see Instruction 16) (20:17)

30 Expenses paid or incurred for housing at your tax home during the year. (If you maintained a qualified second household, see Instruction 17 for additional information)			12,200
31 Figure your base housing amount as follows. Enter;			
(a) Earned income from all sources (see Instruction 16)		55,700	
(b) Qualified schooling expenses (from line 23)	4,000		
(c) Qualified home leave transportation expenses (from line 24)			
(d) Qualified hardship area amount (from line 29)			
(e) Qualified cost-of-living differential (from tables—see Instruction 15)	9,700		
(f) Housing expenses from line 30	12,200		
(g) Total expenses (add lines 31(b) through 31(f)		25,900	
(h) Subtract line 31(g) from line 31(a)		29,800	
(i) Base housing amount: Enter 20% (1/5) of line 31(h)			5,960
32 Subtract line 31(i) from line 30. If less than zero, enter zero			6,240
33 If you maintained a qualified second household, enter earned income as modified by instruction 17(b)(i). Otherwise, omit line 33 and enter zero on line 34(e)			
34 Amount from line 31(g)			
(a) Housing expenses for qualified second household			
(b) Add line 34 and line 34(a)			
(c) Subtract line 34(b) from line 33. If less than zero, enter zero			
(d) Base housing amount for second household; enter 20% (1/5) of line 34(c)			
(e) Subtract line 34(d) from line 34(a)			0
35 Total qualified housing expenses. If you maintained a qualified second household and your tax home was in a hardship area, enter total of amounts on lines 30 and 34(e). Otherwise, enter the total of lines 32 and 34(e). Also enter on line 40			6,240

housing amount. The significance of this amount is obscure, but roughly represents the amount the IRS expects Mr. Buckeye to spend on housing. The deduction for housing is the difference ($6240) between what Mr. Buckeye will likely spend overseas ($12,200) and the amount the IRS expects him to spend ($5960).

As was pointed out in Chapter I, the $6240 deduction would have been greater had the IRS allowed Mr. Buckeye the full $13,700 for COLA that his employer paid him.

The calculations are:

Income	$55,700
Less Schooling expense	4,000
COLA	13,700
Housing expense	12,200
	$25,800

$25,800 x .2 = $5160, the base housing amount;

$12,200 - $5160 = $7040, the housing deduction;

$ 7040 - $6240 = $ 800, lost deduction because of IRS nonrecognition of full COLA.

Each dollar of bonus, key money and auto allowance increases income by one dollar and thereby reduces the base housing deduction by 20 cents. This means to the employee that money paid by the contractor and expected to be completely consumed (e.g., auto allowance), is earned income and will increase his taxes because his housing deduction is reduced. The loss in spending power must be made up by a tax allowance.

APPENDIX C

1979 TAX RATE SCHEDULES

1979 TAX RATE SCHEDULES (19:37)*

If you cannot use one of the Tax Tables, figure your tax on the amount on Schedule TC, Part 1, line 3, by using the appropriate Tax Rate Schedule on this page. Enter the tax on Schedule TC, Part 1, line 4. NOTE: Your new zero bracket amount has been built into these Tax Rate Schedules.

SCHEDULE X--Single Taxpayers

Use this schedule if you checked Filing Status Box 1 on Form 1040--

If the amount on Schedule TC, Part 1, line 3, is:		Enter on Schedule TC, Part 1, Line 4:	
Not over $2,300......		--0--	
Over--	But not over--		of the amount over--
$ 2,300	$ 3,400	14%	$ 2,300
$ 3,400	$ 4,400	$ 154+16%	$ 2,400
$ 4,400	$ 6,500	$ 314+18%	$ 4,400
$ 6,500	$ 8,500	$ 692+19%	$ 6,500
$ 8,500	$ 10,800	$ 1,072+21%	$ 8,500
$ 10,800	$ 12,900	$ 1,555+24%	$ 10,800
$ 12,900	$ 15,000	$ 2,059+26%	$ 12,900
$ 15,000	$ 18,200	$ 2,605+30%	$ 15,000
$ 18,200	$ 23,500	$ 3,565+34%	$ 18,200
$ 23,500	$ 28,800	$ 5,367+39%	$ 23,500
$ 28,800	$ 34,100	$ 7,434+44%	$ 28,800
$ 34,100	$ 41,500	$ 9,766+49%	$ 34,100
$ 41,500	$ 55,300	$13,392+55%	$ 41,500
$ 55,300	$ 81,800	$20,982+63%	$ 55,300
$ 81,800	$108,300	$37,677+68%	$ 81,800
$108,300	----	$55,697+70%	$108,300

*This tax schedule has been modified in format to conform to the margin requirements of this thesis.

SCHEDULE Y—Married Taxpayers and Qualifying Widows and Widowers

Married Filing Joint Returns and Qualifying Widows and Widowers

Use this schedule if you checked Filing Status Box 2 or 5 on Form 1040—

If the amount on Schedule TC, Part 1, line 3, is:		Enter on Schedule TC, Part 1, line 4:	
Not over $3,400......		—0—	
Over—	But not over—		of the amount over—
$ 3,400	$ 5,500	14%	$ 3,400
$ 5,500	$ 7,600	$ 294+16%	$ 5,500
$ 7,600	$ 11,900	$ 630+18%	$ 7,600
$ 11,900	$ 16,000	$ 1,404+20%	$ 11,900
$ 16,000	$ 20,200	$ 2,265+24%	$ 16,000
$ 20,200	$ 24,600	$ 3,273+28%	$ 20,200
$ 24,600	$ 29,900	$ 4,505+32%	$ 24,600
$ 29,900	$ 35,200	$ 6,201+37%	$ 29,900
$ 35,200	$ 45,800	$ 8,162+43%	$ 35,200
$ 45,800	$ 60,000	$ 12,720+49%	$ 45,800
$ 60,000	$ 85,600	$ 19,678+54%	$ 60,000
$ 85,600	$109,400	$ 33,502+59%	$ 85,600
$109,400	$162,400	$ 47,544+64%	$109,400
$162,400	$215,400	$ 81,464+68%	$162,400
$215,400	——	$117,504+70%	$215,400

Married Filing Separate Returns

Use this schedule if you checked Filing Status Box 3 on Form 1040—

If the amount on Schedule TC, Part 1, line 3, is:		Enter on Schedule TC, Part 1, line 4:	
Not over $1,700.......		—0—	
Over—	But not over—		of the amount over—
$ 1,700	$ 2,750	14%	$ 1,700
$ 2,750	$ 3,800	$ 147.00+16%	$ 2,750
$ 3,800	$ 5,950	$ 315.00+18%	$ 3,800
$ 5,950	$ 8,000	$ 702.00+21%	$ 5,950
$ 8,000	$ 10,100	$ 1,132.50+24%	$ 8,000
$ 10,100	$ 12,300	$ 1,636.50+28%	$ 10,100
$ 12,300	$ 14,950	$ 2,252.50+32%	$ 12,300
$ 14,950	$ 17,600	$ 3,100.50+37%	$ 14,950
$ 17,600	$ 22,900	$ 4,081.00+43%	$ 17,600
$ 22,900	$ 30,000	$ 6,360.00+49%	$ 22,900
$ 30,000	$ 42,800	$ 9,839.00+54%	$ 30,000
$ 42,800	$ 54,700	$16,751.00+59%	$ 42,800
$ 54,700	$ 81,200	$23,772.00+64%	$ 54,700
$ 81,200	$107,700	$40,732.00+68%	$ 81,200
$107,700	——	$58,752.00+70%	$107,700

APPENDIX D

TAX RATE SCHEDULE Y--$20,000 TO
$60,000--IN $100 INCREMENTS

Total Income A Dollars	Tax B Dollars	After Tax C Dollars	Total Income A Dollars	Tax B Dollars	After Tax C Dollars
20000	3225	16775	22900	4029	18871
20100	3249	16851	23000	4057	18943
20200	3273	16927	23100	4085	19015
20300	3301	16999	23200	4113	19087
20400	3329	17071	23300	4141	19159
20500	3357	17143	23400	4169	19231
20600	3385	17215	23500	4197	19303
20700	3413	17287	23600	4225	19375
20800	3441	17359	23700	4253	19447
20900	3469	17431	23800	4281	19519
21000	3497	17503	23900	4309	19591
21100	3525	17575	24000	4337	19663
21200	3553	17647	24100	4365	19735
21300	3581	17719	24200	4393	19807
21400	3609	17791	24300	4421	19879
21500	3637	17863	24400	4449	19951
21600	3665	17935	24500	4477	20023
21700	3693	18007	24600	4505	20095
21800	3721	18079	24700	4537	20163
21900	3749	18151	24800	4569	20231
22000	3777	18223	24900	4601	20299
22100	3805	18295	25000	4633	20367
22200	3833	18367	25100	4665	20435
22300	3861	18439	25200	4697	20503
22400	3889	18511	25300	4729	20571
22500	3917	18583	25400	4761	20639
22600	3945	18655	25500	4793	20707
22700	3973	18727	25600	4825	20775
22800	4001	18799	25700	4857	20843

Total Income A Dollars	Tax B Dollars	After Tax C Dollars	Total Income A Dollars	Tax B Dollars	After Tax C Dollars
25800	4889	20911	28800	5849	22951
25900	4921	20979	28900	5881	23019
26000	4953	21047	29000	5913	23087
26100	4985	21115	29100	5945	23155
26200	5017	21183	29200	5977	23223
26300	5049	21251	29300	6009	23291
26400	5081	21319	29400	6041	23359
26500	5113	21387	29500	6073	23427
26600	5145	21455	29600	6105	23495
26700	5177	21523	29700	6137	23563
26800	5209	21591	29800	6169	23631
26900	5241	21659	29900	6201	23699
27000	5273	21727	30000	6238	23762
27100	5305	21795	30100	6275	23825
27200	5337	21863	30200	6312	23888
27300	5369	21931	30300	6349	23951
27400	5401	21999	30400	6386	24014
27500	5433	22067	30500	6423	24077
27600	5465	22135	30600	6460	24140
27700	5497	22203	30700	6497	24203
27800	5529	22271	30800	6534	24266
27900	5561	22339	30900	6571	24329
28000	5593	22407	21000	6608	24392
28100	5625	22475	31100	6645	24455
28200	5657	22543	31200	6682	24518
28300	5689	22611	31300	6719	24581
28400	5721	22679	31400	6756	24644
28500	5753	22747	31500	6793	24707
28600	5785	22815	31600	6830	24770
28700	5817	22883	31700	6867	24833

Total Income A Dollars	Tax B Dollars	After Tax C Dollars	Total Income A Dollars	Tax B Dollars	After Tax C Dollars
31800	6904	24896	34700	7977	26723
31900	6941	24959	34800	8014	26786
32000	6978	25022	34900	8051	26849
32100	7015	25085	35000	8088	26912
32200	7052	25148	35100	8125	26975
32300	7089	25211	35200	8162	27038
32400	7126	25274	35300	8205	27095
32500	7163	25337	25400	8248	27152
32600	7200	25400	35500	8291	27209
32700	7237	25463	35600	8334	27266
32800	7274	25526	35700	8377	27323
32900	7311	25589	35800	8420	27380
33000	7348	25652	35900	8463	27437
33100	7385	25715	36000	8506	27494
33200	7422	25778	36100	8549	27551
33300	7459	25841	36200	8592	27608
33400	7496	25904	36300	8635	27665
33500	7533	25967	36400	8678	27722
33600	7570	26030	36500	8721	27779
33700	7607	26093	36600	8764	27836
33800	7644	26156	36700	8807	27893
33900	7681	26219	36800	8850	27950
34000	7718	26282	36900	8893	28007
34100	7755	26345	37000	8936	28064
34200	7792	26408	37100	8979	28121
34300	7829	26471	37200	9022	28178
34400	7866	26534	37300	9065	28235
34500	7903	26597	37400	9108	28292
34600	7940	26660	37500	9151	28349

Total Income A Dollars	Tax B Dollars	After Tax C Dollars
37600	9194	28406
37700	9237	28463
37800	9280	28520
37900	9323	28577
38000	9366	28634
38100	9409	28691
38200	9452	28748
38300	9495	28805
38400	9538	28862
38500	9581	28919
38600	9624	28976
38700	9667	29033
38800	9710	29090
38900	9753	29147
39000	9796	29204
39100	9839	29261
39200	9882	29318
39300	9925	29375
39400	9969	29432
39500	10011	29489
39600	10054	29546
39700	11097	29603
39800	10140	29660
39900	10183	29717
40000	10226	29774
40100	10269	29831
40200	10312	29888
40300	10355	29945
40400	10398	30002
40500	10441	30059
40600	10484	30116
40700	10527	30173
40800	10570	30230
40900	10613	30287
41000	10656	30344
41100	10699	30401
41200	10742	30458
41300	10785	30515
41400	10828	30572
41500	10871	30629
41600	10914	30686
41700	10957	30743
41800	11000	30800
41900	11043	30857
42000	11086	30914
42100	11129	30971
42200	11172	31028
42300	11215	31085
42400	11258	31142
42500	11301	31199
42600	11344	31256
42700	11387	31313
42800	11430	31370
42900	11473	31427
43000	11516	31484
43100	11559	31541
43200	11602	31598
43300	11645	31655
43400	11688	31712
43500	11731	31769

Total Income A Dollars	Tax B Dollars	After Tax C Dollars	Total Income A Dollars	Tax B Dollars	After Tax C Dollars
43600	11774	31826	46600	13112	33488
43700	11817	31883	46700	13161	33539
43800	11860	31940	46800	13210	33590
39900	11903	31997	46900	13259	33641
44000	11946	32054	47000	13308	33692
44100	11989	32111	47100	13357	33743
44200	12032	32168	47200	13406	33794
44300	12075	32225	47300	13455	33845
44440	12118	32282	47400	13504	33986
44500	12161	32339	47500	13553	33947
44600	12204	32396	47600	13602	33998
44700	12247	32453	47700	13651	34049
44800	12290	32510	47800	13700	34100
44900	12333	32567	47900	13749	34151
45000	12376	32624	48000	13798	34202
45100	12419	32681	48100	13847	34253
45200	12462	32738	48200	13896	34304
45300	12505	32795	48300	13945	34355
45400	12548	32852	48400	13994	34406
45500	12591	32909	48500	14043	34457
45600	12634	32966	48600	14092	34508
45700	12677	33023	48700	14141	34559
45800	12720	33080	48800	14190	34610
45900	12769	33131	48900	14239	34661
46000	12818	33182	49000	14288	34712
46100	12867	33233	49100	14337	34763
46200	12916	33284	49200	14386	34814
46300	12965	33335	49300	14435	34865
46400	13014	33386	49400	14484	34916
46500	13063	33437	49500	14533	34967

Total Income A Dollars	Tax B Dollars	After Tax C Dollars	Total Income A Dollars	Tax B Dollars	After Tax C Dollars
49600	14582	35018	52600	16052	36548
49700	14631	35069	52700	16101	36599
49800	14680	35120	52800	16150	36650
49900	14729	35171	52900	16199	36701
50000	14778	35222	53000	16248	36752
50100	14827	35273	53100	16297	36803
50200	14876	35324	53200	16346	36854
50300	14925	35375	53300	16395	36905
50400	14974	35426	53400	16444	36956
50500	15023	35477	53500	16493	37007
50600	15072	35528	53600	16542	37058
50700	15121	35579	53700	16591	37109
50800	15170	35630	53800	16640	37160
50900	15219	35681	53900	16689	37211
51000	15268	35732	54000	16738	37262
51100	15317	35783	54100	16787	37313
51200	15366	35834	54200	16836	37364
51300	15415	35885	54300	16885	37415
51400	15464	35936	54400	16934	37466
51500	15513	35987	54500	16983	37517
51600	15562	36038	54600	17032	37568
51700	15611	36089	54700	17081	37619
51800	15660	36140	54800	17130	37670
51900	15709	36191	54900	17179	37721
52000	15758	36242	55000	17228	37772
52100	15807	36293	55100	17277	37823
52200	15856	36344	55200	17326	37874
52300	15905	36395	55300	17375	37925
52400	15954	36446	55400	17424	37976
52500	16003	36497	55500	17473	38027

Total Income A Dollars	Tax B Dollars	After Tax C Dollars	Total Income A Dollars	Tax B Dollars	After Tax C Dollars
55600	17522	38078	57900	18649	39251
55700	17571	38129	58000	18698	39302
55800	17620	38180	58100	18747	39353
55900	17669	38231	58200	18796	39404
56000	17718	38282	58300	18845	39455
56100	17767	38333	58400	18894	39506
56200	17816	38384	58500	18943	39557
56300	17865	38435	58600	18992	39608
56400	17914	38486	58700	19041	39659
56500	17963	38537	58800	19090	39710
56600	18012	38588	58900	19139	39761
56700	18061	38639	59000	19188	39812
56800	18110	38690	59100	19237	39863
56900	18159	38741	59200	19286	39914
57000	18208	39792	59300	19335	39965
57100	18257	38843	59400	19384	40016
57200	18306	38894	59500	19433	40067
57300	18355	38945	59600	19482	40118
57400	18404	38996	59700	19531	40169
57500	18453	39047	59800	19580	40220
57600	18502	39098	59900	19629	40271
57700	18551	39149	60000	19678	40322
57800	18600	39200			

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